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Subject: Ottawa vows to ramp up terrorism fight AND OTHERS

The Globe and Mail

By/Par: Colin Freeze, Laura Stone

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Photo: No

After the fatal police shooting of would-be suicide bomber Aaron Driver, the Public Safety Minister says the Liberals will "up our game" in the fight against terrorism by imminently hiring a deradicalization adviser.

"What the incident in Strathroy demonstrates is that this is important," Ralph Goodale told reporters on Wednesday. He said the new adviser will be hired within weeks and could succeed in counterterrorism challenges where police and intelligence services are falling short.

Mr. Driver, 24, from Strathroy, Ont., was killed last week. Federal authorities had red-flagged him as an aspiring terrorist, but nothing could make him reconsider his sworn allegiance to the Islamic State. Despite a degree of monitoring, he had managed to put together an improvised bomb and a video in which he promised to shed Canadian blood for the terror group.

The creation of a deradicalization adviser, who will run a \$10million-a-year office, fulfills a 2015 campaign promise by the Liberals. At the time, the party criticized the then-Conservative government for its law-and-order approach to fighting terrorism.

Details are under wraps, but observers are keen to see how the approach will take shape, especially since the global track record of such initiatives is mixed.

"There are all kinds of these programs all over the world. Everyone's got one," said Phil Gurski, a former analyst at the Canadian Security Intelligence Service. And yet, he added, no one has really figured out the best approach.

CSIS recently canvassed outside experts for feedback on which governments' deradicalization - or "countering violent extremism" (CVE) - programs are working best. Many replied that none are known to be working particularly well.

"Some expressed skepticism as to the relevance of CVE initiatives, highlighting the lack of supporting empirical evidence thus far to measure their effectiveness," says a CSIS discussion paper recently published online.

Other experts told CSIS such programs are only valuable "provided that their implementation is not led by governments ... [because] governments are not credible messengers."

Speaking to reporters after a speech to the Canadian Association of Chiefs of Police on Wednesday, Mr. Goodale said he is mulling over who among two or three short-listed candidates will lead the government's newest office. "We will be making the selection shortly," he said. "That person will be directing a very important effort to up our game in Canada in terms of recognizing and understanding the process of radicalization."

The minister said the new adviser will focus on how to nip extremism in the bud, as well as on how to unlock the psyches of hardened extremists. Mr. Driver was for years an active cheerleader of the Islamic State on Twitter.

Last year, police compelled him to appear in court to swear a specialized peace bond that exists for terrorism suspects.

A judge extracted a promise from Mr. Driver that if he wanted to stay out of jail, he would keep away from weapons and Internet propaganda, and check in with police every two weeks. Yet the threat posed by Mr. Driver was never adequately contained because he never altered his beliefs.

Mr. Goodale said that, down the road, he is open to tinkering with peace-bond laws to better require "an individual to engage with counter-radicalization professionals" - but he stressed that no peace bond will ever be a "panacea" in itself.

The Conservatives' public-safety critic, Erin O'Toole, said he will be watching to see how the new office takes shape.

"Will this co-ordinator be able to cure people or bring them back from the brink?" he asked.

He said the Liberals should also consider that police may still need more powers. "Let's not kid ourselves if law enforcement agencies need some tools to keep on top of this."

Over the years, the federal government has tried to come up with ways to challenge radicalization. For example, the RCMP and the Department of Public Safety have spent years trying to devise their own CVE initiatives but have had little to say about their successes or failures.

"I know the people who have been involved in it ... but I haven't seen any results," said Mr. Gurski, the former CSIS analyst.

"Let's not be Pollyannas about this - this stuff is hard," he added. But "at the end of the day, doing something is better than doing nothing. Because if you do nothing, you end up with Aaron Driver

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Liberals eye tougher laws after terrorism near-miss; Deradicalization counselling among federal proposals in wake of foiled attack

Toronto Star

By/Par: Tonda MacCharles

Date: 2016-08-18

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Photo: No

The federal Liberal government says it may toughen the law on peace bonds to require terrorist sympathizers to take mandatory deradicalization counselling.

Public Safety Minister Ralph Goodale said the death last week of Aaron Driver in Strathroy, Ont., where RCMP sharpshooters believe they pre-empted a planned terror attack, showed the current limitations of peace bonds.

"We have recognized, for this incident and beyond it, that peace bonds have some usefulness but they're not a panacea," Goodale told reporters. "They're a tool that has limitations."

One option for the federal Liberal government, which is undertaking widespread public consultations on the country's national security laws, is to require individuals who are subject to a peace bond to meet regularly with deradicalization experts, he said.

However, Goodale acknowledged there are not many such experts or counsellors in Canada.

He said that is "exactly why" the federal government is spending \$35 million to set up a centre for countering violent extremism - "to have national capacity and national coherence to deal with these very issues."

The Liberals promised the centre in last year's election campaign "and we were scoffed at," he said. But it is still not up and running.

The Driver case has put a new spotlight on deradicalization efforts and on peace bonds, he admitted.

Under the Criminal Code, in cases where there may not be enough evidence to lay charges, police and prosecutors may seek a peace bond - a legal court order that restricts the movements, communications and activity of admitted terror sympathizers - which the individual agrees to.

Goodale said any peace bond changes would come as part of a package of changes the government is looking at in its review of Canada's national security framework, and Bill C-51, the Conservatives anti-terror law of 2015.

Consultations on the long-promised law reforms will be completed by "the end of the year," he said.

"One particular tool obviously was not effective in dealing with that particular (Strathroy) case," Goodale said, but he stressed the government would not act hastily.

"Some of the problem with our laws in the past, they've been developed in a haphazard manner and have not had the intense scrutiny and consideration they need to get it right."

Driver was under a judge-ordered peace bond with strict conditions meant to limit his movements, travel, Internet communications and cellphone use after he was first arrested in June 2015.

Certain conditions of Driver's release had been relaxed while others were soon set to expire. His family was worried, although he appeared polite and friendly to many who met him.

He was able to acquire bomb-making materials, make a "martyrdom video" and set out to blow up a device with the goal of causing mass casualties in an urban area during rush hour.

He was foiled when the FBI tipped the RCMP to a plot by a then-unknown assailant. Driver got as far as detonating an explosive in a taxi en route to carry out his plan, before he was shot by the RCMP.

Using online aliases, including Harun Abdurahman and Harun Danyal on Twitter when he was profiled last year by the Star's Allan Woods, Driver came to police attention after he glorified terrorist activity by Daesh, also known as ISIS or ISIL, its brutal beheadings and executions, and the October 2014 attack on Parliament Hill.

Security agencies linked his social media communications with known terrorist plotters in the U.K. and Australia, as well as the shooter who attacked the Curtis Culwell Center in Texas during a cartoon contest featuring images of the Prophet Muhammad.

Gatineau police chief Mario Harel, the new head of the Canadian police chiefs association, told the Star that police recognize it takes time to do things right "so if that consultation permits every party" to provide input for "good solid modification to the policies, well that's great."

Harel wouldn't comment on the Driver case. He said police can work with peace bonds, but "it could" be strengthened.

He said there are "all sorts of other investigation tools that are in place in different agencies. We'll work with them for now."

In his speech, Goodale highlighted the threat of lone-wolf terrorists, the threats to cybersecurity and the need for Canadians to engage in a national conversation about how to strike the right balance between individual privacy rights and law-enforcement tools.

Laurie Hawn, a former Conservative MP who is now a member of the Edmonton Police commission, told the Star that consultations are important but they are also "a good way to kick things down the road."

"All governments do that," she said. "We did it, too. They've got to get it right, but with things like cyber (security) and things that are so technical and dynamic, you've got to move fairly quickly. If you can't get it 100-per-cent right, if you've got 80 to 90 per cent, you better start moving on it

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RCMP feared keeping terror suspect at home could backfire; Blocking extremist's travel to Syria may have led to attacks in Canada, police warned in documents

Toronto Star

By/Par: Allan Woods

Date: 2016-08-18

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Photo: No

As Public Safety Minister Ralph Goodale promised to toughen the requirements on terror suspects who are subject to restrictive peace bonds, newly unsealed court documents show police feared one Montreal man could launch an attack in Canada if he were prevented from travelling abroad.

The warning from RCMP Cpl. Brenda Makad is contained in a police affidavit used in support of a peace bond application in 2015 against Daniel Minta Darko.

"Even though I believe that the desire to leave Canada in order to join the fighting in Syria is Darko's priority, the call to action in the West and the incidents Canada has suffered recently lead me to fear that faced with the impossibility of leaving, Darko would act here," Makad said in the affidavit.

The 28-year-old Muslim convert, along with Merouane Ghalmi, 24, travelled halfway around the world to try to "shuffle the cards" and throw authorities off their trail, the police allege in the affidavit. They were intercepted in Turkey and returned to Canada, the affidavit said.

In Canada, RCMP officers investigated and interviewed the two men.

Individual affidavits of the interviews were then used to obtain peace bonds - with restrictive conditions - against both. Among the allegations in the police affidavits: Darko lied to police and Daesh propaganda was found on his cellphone, and Ghalmi enjoyed a close friendship with Canadian jihadist Sami Elabi. The two affidavits were released in a Montreal court Wednesday after a media challenge of the sealing order.

Darko did not respond to a request for an interview. Ghalmi could not be reached for comment. The peace bonds against the two men were in effect for 12 months and expired earlier this year, Crown prosecutor Lyne Décarie said in an email to the Star.

Goodale's focus on peace bonds comes just days after Aaron Driver, a 24-year-old Daesh sympathizer, was shot dead by police in Strathroy, Ont. Driver was within 72 hours of committing a terror attack on Canadian soil, police have claimed. Driver was under a peace bond with restrictive conditions, and was still able to acquire bomb-making materials and make a "martyrdom video."

It's the restrictive nature of peace bonds that has least one expert wondering if they only further isolate would-be radicals.

The problem with peace bonds, said Canadian terrorism researcher Amarnath Amarasingam, is that there are only restrictions - on movement, on communication, on association - without positive intervention.

"There is no followup, no attempt to provide further help and supervision," he said. "We tell them what they can't do and leave it at that."

Peace bonds are used to place restrictions on the movements and associations of people who are believed by police to be at risk of committing a criminal offence, even if there is insufficient evidence to show that a law has been broken. A peace bond is not an admission of guilt and must be agreed to by the person it is issued for. Police have used them a handful of times on people deemed to be at risk of committing a terrorism offence.

In the case of the two Montreal men, the Mounties suspected Darko and Ghalmi had travelled from Montreal to Toronto to Hong Kong to Kuala Lumpur, Malaysia, to Istanbul, Turkey, with the goal of joining a terrorist group in Syria, the police affidavit said.

Darko and Ghalmi left Canada on Jan. 22, 2015, and were turned back by Turkish authorities on Jan. 28, 2015, after arriving in Istanbul, the affidavits said.

They returned to Montreal less than two weeks after leaving and were questioned by national security investigators about the depth of their commitment and beliefs, the police affidavit said.

The details of the Montreal case raise some of the same questions now being asked publicly in the debate over the death of Driver, including how closely individuals believed to pose a terror threat are being tracked in Canada as well as what support, counselling and intervention they should or do receive.

In Ottawa Wednesday, Goodale said the federal government is now considering tougher conditions for terror-related peace bonds that could include mandatory deradicalization counselling as a package of reforms to last year's anti-terrorism legislation.

Goodale told reporters that while peace bonds could be a useful tool in controlling individuals deemed to pose a terror risk, they are "not a panacea."

The case involving Driver and the fact that he was able to assemble a bomb as well as produce and post a chilling martyrdom video to the web while supposedly barred from having a computer and cellphone shows that "one particular tool obviously was not effective in dealing with that particular case," Goodale said.

In the Montreal case, Ghalmi, a former kick-boxer, was allegedly the mastermind behind the plan to leave for Syria, the affidavit said. He had tried unsuccessfully to make the trip in July 2013 but was arrested at the Turkish-Syrian border and returned home, the six-page affidavit outlining the police investigation said.

Ghalmi also had the on-the-ground contacts in both countries, including a close friendship with Canadian jihadist, Sami Elabi, who has fought with the Free Syrian Army, Daesh and Jabhat al-Nusra, the police affidavit said.

It was Ghalmi who invited Darko to come with him just five days before their departure, which the RCMP learned about only after being tipped off in a telephone call from Ghalmi's worried sister, according to the police affidavit.

After the two men were turned back from Turkey and returned to Montreal, their passports were seized and they were brought in for questioning, Ghalmi was open about his beliefs under questioning by the police, the affidavit said.

On his computer, police discovered photos of dead jihadists, as well as audio files of speeches by leaders of Daesh and Ansar Al-Charia, although Ghalmi allegedly told investigators that the extremist militant group Ahrar Al-Sham was the one that he felt most drawn toward, the affidavit said.

He told investigators that living an Islamic life in the West was like trying to mix "oil and vinegar." He said he felt judged while living in Montreal because of his beard and his lifestyle and that having his passport seized or being included on a no-fly list would not deter him from his ultimate goal, the affidavit said.

With files from Tonda MacCharles

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Terrorism darkens our doorstep

Toronto Star

By/Par: Judith Timson

Date: 2016-08-18

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Photo: No

Last Wednesday afternoon, when I was idly musing about how hot it was and what to do for supper, a friend contacted me and told me something startling.

"There is a credible threat of a suicide bomb in downtown Toronto tonight," she said. "So be careful if you are out and about."

She is my most unflappable friend, not in the media, not interested in gossip or making outrageous statements.

She gave me her source, which involved the police and to me, it seemed pretty good. "Scary," I said, and asked if she was free for lunch tomorrow.

How banal is that? My terrorism sang-froid lasted only another few seconds before I began to worry. My husband was safe at home, my daughter and her husband live in Paris (hah), but my son is always "out and about" in downtown Toronto.

I decided to warn him, as I began searching Twitter and news sites for any hint of a raised threat level. None.

I also emailed my editors, with the subject heading: "Are you hearing anything about a credible bomb threat in downtown Toronto tonight?"

By this time, it seemed surreal, sitting at my kitchen counter, warning my son who was about to leave work and board transit that there may be a bomb somewhere, anywhere - Transit? Union Station? A public event?

How do you even narrow down the choices a suicide bomber could make in "downtown Toronto"?

Please be careful, I thought, not wanting to say "stay home." Knowing also he had to get to his home to stay home.

I wondered whether I should alert other family, including nieces and nephews most likely to be in the downtown area.

But "it" could be anywhere, I mused. Why scare everyone into changing plans?

Within a few hours, the story had broken. A young man named Aaron Driver, who was known to police as a Daesh sympathizer, had just been killed - we now know by a single police bullet - during a police operation in Strathroy, Ont.

The operation had been mounted quickly after the FBI had sent the RCMP a "martyrdom" video that morning in which a partly masked man, subsequently identified as Driver, 24, warned Canadians "would pay today" for actions in the Middle East. Authorities believed Driver was about to carry out an attack on a crowded urban centre during rush hour.

Driver, apprehended getting into a cab, was carrying at least one explosive which detonated in the cab. He might have been going to a London, Ont., mall and not, as some people were subsequently saying on Twitter, to Union

Station. His ultimate destination was unknown. Although late that afternoon, there seemed to be a heavier-than-usual police presence at Union Station.

The next day, CBC's As It Happens interviewed Driver's anguished father, Wayne, a retired military officer who says he didn't blame the police action, but was grappling with the death of a difficult son. Things had been tough for Aaron, he said, since at age 7 he had lost his mother to cancer.

Driver's history with police began after the Ottawa shooting attack in 2014 in which Cpl. Nathan Cirillo was killed. Driver publicly defended the attack in media interviews and became an outspoken Daesh sympathizer.

Police subsequently had him in custody, then on a peace bond with a GPS ankle bracelet. But some sanctions were lifted when he went to Strathroy to live with his sister. He seemed to be no longer under surveillance.

Speaking out "just so they know he was a human being" and that "he was loved," Wayne Driver said his daughter, with whom Driver was living, was now, in his words, "a mess." She had four children in their home, ranging in age from 9 to 16, as her brother was apparently concocting his deadly plan.

"Islam isn't necessarily a bad religion. It's what you choose to do with it," Wayne Driver, a Christian pastor in training, told the CBC.

Aaron would have turned 25 on Thursday. The family says it will give him an Islamic funeral that day to honour his wishes.

His father told As It Happens he tried to stay in touch with his son but was rebuffed. More recently, Wayne Driver was quoted by the Star's Alex Ballingall saying he was trying to remember Aaron's childhood. One moment in particular sticks out, Driver said: teaching Aaron to roller skate, just before his mother died. "It's one of my favourite memories," he said. "I'd rather remember him that way."

Extraordinary that a father is so outspoken and eloquent, and while grieving, even accepting of how his son died.

In the As It Happens interview he said he was "surprised" the police hadn't detained his son, although "I guess he hadn't broken any law."

Since this event, Public Safety Minister Ralph Goodale has talked about "increased vigilance," and a "robust security alliance" between Canada and the U.S.

Nothing seemed "robust" to me when I got that personally delivered bomb warning.

How helpless a local "credible" terrorism threat can make you feel. Yet how vague and only "probable" it seems until something actually happens. Ill-defined too - before and after. In some recent attacks, there has been a debate - terrorism or just another madman?

Millions of people all over the world live with this threat on a daily, even hourly basis - Israelis, Afghans, Syrians and the French to name a few.

They don't think: "It might happen." They think: "It will happen."

Here, I would have still hopefully said "might."

Now I say "will." Or to put it more calmly, a terrorism attack in downtown Toronto, especially by a lone-wolf operative, is entirely plausible.

The trick is learning to live with it.

Judith Timson writes weekly about cultural, social and political issues. You can reach her at judith.timson@sympatico.ca and follow her on Twitter @judithtimson

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Feds eyeing mandatory counselling for terror suspects under peace bonds **New Brunswick Telegraph-Journal**

By/Par: Jim Bronskill

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Photo: No

OTTAWA * The Liberal government is looking at making counter-radicalization counselling mandatory for people under anti-terrorism peace bonds, the public safety minister says.

Ralph Goodale floated the idea one week after jihadi sympathizer Aaron Driver was killed by police in Strathroy, Ont.

Driver, 24, was under a court-ordered peace bond intended to limit his activities but he was able to obtain explosives, plan an apparent attack and film a martyrdom video.

Police got wind of his plans through a tip from the U.S. Federal Bureau of Investigation and intercepted him as he was leaving his southwestern Ontario home in a taxi.

Driver's death has prompted questions about the effectiveness of peace bonds and whether more could have been done to steer him onto a better path.

There were some ad hoc interventions aimed at helping deradicalize Driver but nothing deliberate and well-organized, Goodale said Wednesday after a speech to the Canadian Association of Chiefs of Police.

The government is looking for ways to make peace bonds more effective - perhaps involving community outreach organizations - or to find alternatives to the judicial tool, which is not a panacea, he said.

"It's not a perfect solution to every situation."

Goodale declined to discuss Driver's actions, saying the details are still under police investigation. Nor would he comment on whether surveillance had been stepped up on the dozen or so people currently under anti-terrorism peace bonds.

The RCMP has acknowledged that Driver was not under constant surveillance.

"That is obviously a lesson that one needs to look at very carefully, as a result of the incident in Strathroy," Goodale said. "And we are examining very carefully what we need to do to make our police and security activity more effective."

Goodale said the government would move as rapidly as possible, but he stressed that good laws are not developed "in a panic."

A federal consultation on national security, to conclude by the end of the year, must happen first, he said.

"We want to do this right. Some of the problem with our laws in the past is they've been developed in a haphazard manner and have not had the intense scrutiny and consideration that they need in order to get it right," Goodale said.

"I've obviously got to do this in a coherent and sensible way, not scribbled down on the back of an envelope."

As a first step, the Liberals plan to open a federal office of counter-radicalization to serve as a national focal point for research, counselling and intervention services.

"We are in the process of recruiting the person that will lead the effort. And we are determined to get this office up and running toward the end of the summer, the beginning of the fall," Goodale said.

"The incident in Strathroy demonstrates how very important this priority is."

In his address to the chiefs, Goodale said one of government's biggest security concerns are the "lone wolves" who are drawn into perverse and extreme ideologies that promote death and destruction.

"We need to understand what positive messages can counteract the insidious poison that draws people in, especially young people

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Civil liberties struggle under Liberals as much as Conservatives; Government dragging its heels on review of security legislation

Saskatoon StarPhoenix

By/Par: Greg Fingas

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Photo: No

Canada's ongoing debate over the protection of civil liberties has taken a few noteworthy turns this summer. And what's normally considered a quiet season could have significant ramifications for Canadians, whether or not they're currently monitoring the political scene.

On the one hand, the federal NDP has reiterated its outrage at C-51, the surveillance bill that was forced through by Stephen Harper's Conservative government with the supposedly grudging support of Justin Trudeau's Liberals. Since taking power, the Liberals have made excuses to drag their heels even in providing minimal accountability for the exercise of wide-ranging powers to intrude on Canadians' civil rights.

It took until June for them to even introduce legislation to establish a secret committee of parliamentarians. And we can hardly take solace in a committee limited to carrying out after-the-fact reviews of security activity and lacking any ability to inform the public of any abuses without the government's approval.

Even worse, the Liberals haven't even started the process of reviewing our security state in substance. And any meaningful review of C-51 figures to become more difficult as authorities claim that their practices have become too entrenched to change.

Faced with that pattern of delay, NDP MP Randall Garrison has announced his intention to introduce a private member's bill to put the contents of C-51 to an immediate test. And the Liberals will thus have to answer for their complete lack of action in revisiting even elements of C-51 they criticized when it was passed.

At the same time, the Conservatives and others are not only refusing to acknowledge any flaws in Canada's existing security state, but are also hinting at demanding even more of a crackdown on personal freedoms. And some seem to be treating the foiled attack planned by Aaron Driver as an excuse for even more surveillance and disruption powers.

Lest anybody think those calls are any more founded in reality than the scaremongering behind C-51, though, it's worth noting that none of the measures put in place through C-51 look to have helped in Driver's case.

In fact, the peace bond scheme pushed by the Conservatives failed utterly. Despite being subject to limits on individual action set up by C-51, Driver - working alone - was able to assemble an explosive device as part of a plan to attack civilians.

Moreover, it was FBI surveillance, not any action by CSIS or any other Canadian authority, that identified Driver's plans in time for the RCMP to respond. Yet somehow we're now facing calls for even more severe intrusions on privacy.

Most notably, the Canadian Association of Chiefs of Police (CACP) recently passed a resolution seeking the authority to require people to provide their personal electronic passwords to police during an investigation.

That move would allow complete state access to the nearly unlimited range of personal information found on our phones, computers and other devices - and for purposes

dealing with investigations in hindsight, not the prevention of future threats.

To be clear, we need to evaluate both the legislation we have and any new proposals based on an assessment of what's actually needed to keep us safe.

But the onus needs to be on anybody promoting surveillance and disruption powers to explain what specific problem they're intended to address and to tailor those powers to minimize the impact on our freedoms.

Neither C-51's grant of nearly boundless authority in the name of nebulous "security" nor the CACP's demand that we forfeit our privacy for the convenience of investigators comes anywhere close to meeting that standard. Fingas is a Regina lawyer, blogger and freelance political commentator who has written about provincial and national issues from a progressive NDP perspective since 2005. His column appears every Thursday. You can read more from Fingas at www.gregfingas.com

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Law forcing you to hand over passwords unlikely to pass, lawyers say **Calgary Herald (Blog)**

By/Par: Calgary Herald, Emma McIntosh

Date: 2016-08-18

Photo: No

A new law being sought by police chiefs that would force civilians to hand over electronic passwords would likely violate civil rights.

As a result, experts say, it's very unlikely to ever come to pass.

"We do have rulings in Canada and in other jurisdictions that say this type of mandated disclosure is not acceptable, specifically because it forces people to participate in their own incrimination," said Tamir Israel, a lawyer for the Ottawa-based Canadian Internet Policy and Public Interest Clinic (CIPPIC).

Calgary police Chief Roger Chaffin was among those at the Canadian Association of Chiefs of Police who voted Tuesday to ask for legal means to obtain passwords(<http://calgaryherald.com/news/local-news/calgary-police-support-call-for-law-that-would-force-people-to-reveal-passwords>), saying it would help law enforcement keep pace with cybercrime.

The CACP is a lobbying organization, and the resolution passed has no effect on current law. Though details on prospective legislation weren't released, RCMP assistant commissioner Joe Oliver said Tuesday that any searches would require a judge's permission.

Israel said that depending on what the specifics of such a law would be, it's very likely it would violate Canadians' right to not self-incriminate, and not stand up to scrutiny from the Supreme Court of Canada.

"It's hard to fully assess it without knowing the full parameters of what they have in mind," he said.

Previous Supreme Court rulings have said it's OK for law enforcement to go into devices in certain, limited contexts. Officers can do a cursory search of a phone unprotected by a password or passcode shortly after arresting someone, for example.

However, they can't take an in-depth look or try to get into a password-protected device without a warrant, nor can they force anyone to give them a password.

The Calgary Police Service declined to speak to Postmedia for this story.

However, on Tuesday, Dep. Chief Sat Parhar, who voted in favour of the resolution, said a law granting police access to passwords would help with a range of cases, from everyday fraud to possible terrorism.

"We don't want to abuse it - the idea here is that we're actually going through a process that's guided by law," Parhar said.

"Police have to have a presence in that world."

But Israel said police already have access to more information than ever before, and workarounds can often retrieve the information without accessing the whole device.

"The use of passwords and encryptions forces police to use more targeted tools," he said.

This isn't the first time the CACP has asked for powers beyond what the law currently allows. Last year, it passed a resolution to ask for access to real-time telecom subscriber information without a warrant, but the idea was never put into law.

Rocky Mountain Civil Liberties Association director Sharon Polsky said Canadians should be aware of the balance between revealing information for the common good and violating civilians' privacy.

"(More information is) not necessarily a bad thing, but we don't know what they're going to do with it," she said.

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Striking the right balance

Toronto Star

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Photo: No

Handing over the electronic password to your computer or cellphone to police could give them more access to your personal information than turning over the key to your house.

That's why Canadians must carefully guard their privacy rights when considering any proposal to make it easier for law enforcement officials to rummage through their digital data - everything from names and addresses, emails and texts, bank information, photos and Internet browsing history. A virtual snapshot of our private lives.

Public Safety Minister Ralph Goodale is calling for a public discussion on how to strike the right balance between the need for privacy and the need to give police adequate tools to fight all sorts of Internet- and computer-related crime.

It's a debate that's long overdue. And it's one that cannot be delayed much longer in light of a high-profile call from the country's police chiefs for a new law that would force people to hand over electronic passwords, albeit with the permission of a judge.

The Canadian Association of Chiefs of Police argues quite rightly that electronic devices are being used in the commission of all sorts of crime - from fraud to child abuse - and law enforcement is struggling to keep up. It notes that Canada has no law to compel someone to provide a password or encryption key during an investigation.

The trick is to find a way to give police the powers they really need while safeguarding the right to privacy, as well as constitutional guarantees against self-incrimination and unreasonable search and seizure.

Some experts, such as David Fewer of the Canadian Internet Policy and Public Interest Clinic at the University of Ottawa, argue that the police chiefs' proposal goes so far that it is "plainly unconstitutional."

But others, such as Ann Cavoukian, Ontario's former privacy commissioner who now heads the Privacy and Big Data Institute at Ryerson University, point out that it is possible to address cybercrime while also safeguarding rights.

She makes a number of sensible suggestions that can usefully inform the coming debate. Any law forcing a person to hand over electronic passwords to police, she says, should require a judicial warrant that would include certain elements:

Reasonable and probable grounds of a potential crime must be shown in the warrant.

It can't be a fishing expedition. The warrant would have to describe exactly what police are looking for.

The password should be handed over to a third party who would look just at the described information, and that data only, and pass it back to police.

Police should look at all the other leads available to them before requesting a warrant for a password.

These are the kind of concrete suggestions that should be part of the three-month public consultation on cybersecurity launched by Ottawa this week. It will provide an opportunity to thoroughly examine proposals like the one from the police chiefs to ensure they don't overshoot the mark.

Police are right to want the tools they need to protect citizens from online criminal threats. But Canadians should not have to toss away personal freedoms to achieve that goal.

Two years ago, in a ruling on cellphones and privacy, three dissenting judges on the Supreme Court of Canada wrote presciently that "as technology changes, our law must also evolve so that modern mobile devices do not become the telescreens of George Orwell's 1984." The surveillance tools now available to the state are more powerful and potentially intrusive than ever before. As Orwell understood, there's a delicate balance to be struck

Goodale says peace bond failed; 'Limited Capacity'

National Post

By/Par: Ian Macleod

Date: 2016-08-18

Page: A1 / Front

Photo: No

Anti-terror laws need work, says safety minister

Stronger antiterror measures are needed after a court-ordered peace bond failed to stop jihadist Aaron Driver from making bombs and plotting an attack, Public Safety Minister Ralph Goodale said Wednesday.

"What the incident shows is that peace bonds are tools and instruments with limited capacity; it's not a perfect solution to every situation," Goodale told reporters Wednesday after a speech to the Canadian Association of Chiefs of Police.

One option would be to amend the Criminal Code to require professional deradicalization counselling for individuals suspected as terrorist sympathizers "to change (their) behaviour," he said.

Peace bonds generally demand that a person "keep the peace and be of good behaviour" and are a useful tool for police when they do not have sufficient evidence to prosecute an individual criminally but believe that protection beyond surveillance is required. Judges typically attach additional conditions on the recommendation of police. Driver's initial June 2015 peace bond required him to "participate in religious counselling." He launched a constitutional challenge in court and in January a judge ruled the condition violated his Section 2 Charter right to freedom of conscience and religion. A requirement he wear a GPS tracking bracelet was later lifted by another judge.

Driver's killing by police outside his home in Strathroy, Ont., last week is the second time the peace bond regime has been unable to stop a suspected dangerous individual.

Weeks before ISIL sympathizer Martin Couture-Rouleau struck and killed Warrant Officer Patrice Vincent with a car in St-Jeansur-Richelieu, Que., on Oct. 20, 2014, police considered seeking a peace bond to restrict his movements after Couture-Rouleau's father told police his son had become radicalized. Authorities concluded they did not have sufficient grounds to secure a peace bond from a judge.

The then-Conservative government quickly responded with Bill C-51, the controversial legislation giving security services and police sweeping powers to combat threats to national security. It included lowering the standard-of-proof threshold for obtaining peace bonds against individuals suspected of engaging in or helping with terrorist activities.

Now that Criminal Code provision, too, appears to be wanting.

"Based on the experience of Strathroy, we obviously need to examine those provisions in the code to see where corrections need to be made, where strengthening can be provided, where the whole impact of the use of this tool can be made more effective," Goodale said.

Leading terrorism experts say the problem goes beyond court orders to keep the peace, especially when dealing with individuals willing to sacrifice their lives for the jihadist cause.

Peace bonds are based on threat assessments by the RCMP, possibly with input from the Canadian Security Intelligence Service (CSIS). With Driver and Couture-Rouleau, those assessments proved to be wrong, said Wesley Wark, a terrorism expert at the University of Ottawa.

"That threat assessment was basically that Aaron Driver was a person that liked to talk very openly about his support for the Islamic

State (of Iraq and the Levant), jihad and all the rest of it, but was unlikely to take any action," he said.

"Who at the end of the day has the final say on the threat assessment? How do they come up with judgments and were those judgments reviewed from time to time or were they set in stone?" Breaching the conditions of a national security peace bond - not using a computer, for example - can result in up to four years in prison. Civil libertarians and others, however, say that can allow authorities to imprison a person without the state having to mount any criminal prosecution in court.

Goodale said possible changes to the peace bond regime will be considered as part of the government's review of national security laws and practices, including long-promised reforms of the "problematic elements" of C-51, now known as the Anti-terrorism Act of 2015.

A government national security framework consultation paper, to have been released two weeks ago, is now expected out in the fall. Goodale said the Liberals will spend the rest of the year consulting and gathering feedback from experts and the public.

That means the Liberals' promised repeal of parts of C-51 won't happen until next year at the earliest.

Goodale bristled when reporters suggested the government appears to be ragging the puck on C-51 reform.

"We are going to do this in a proper, intelligent way," he fired back. "You develop good law by taking people's views into consideration and thoughtfully proceeding ... so that the law will withstand the test of time and keep Canadians safe and safeguard the values of Canada. Those are too-important things to deal with in a superficial or incoherent way."

imacleod@postmedia.com @macleod_ian

Stephen Bindman

Special Advisor on Wrongful Convictions//Conseiller spécial, erreurs judiciaires

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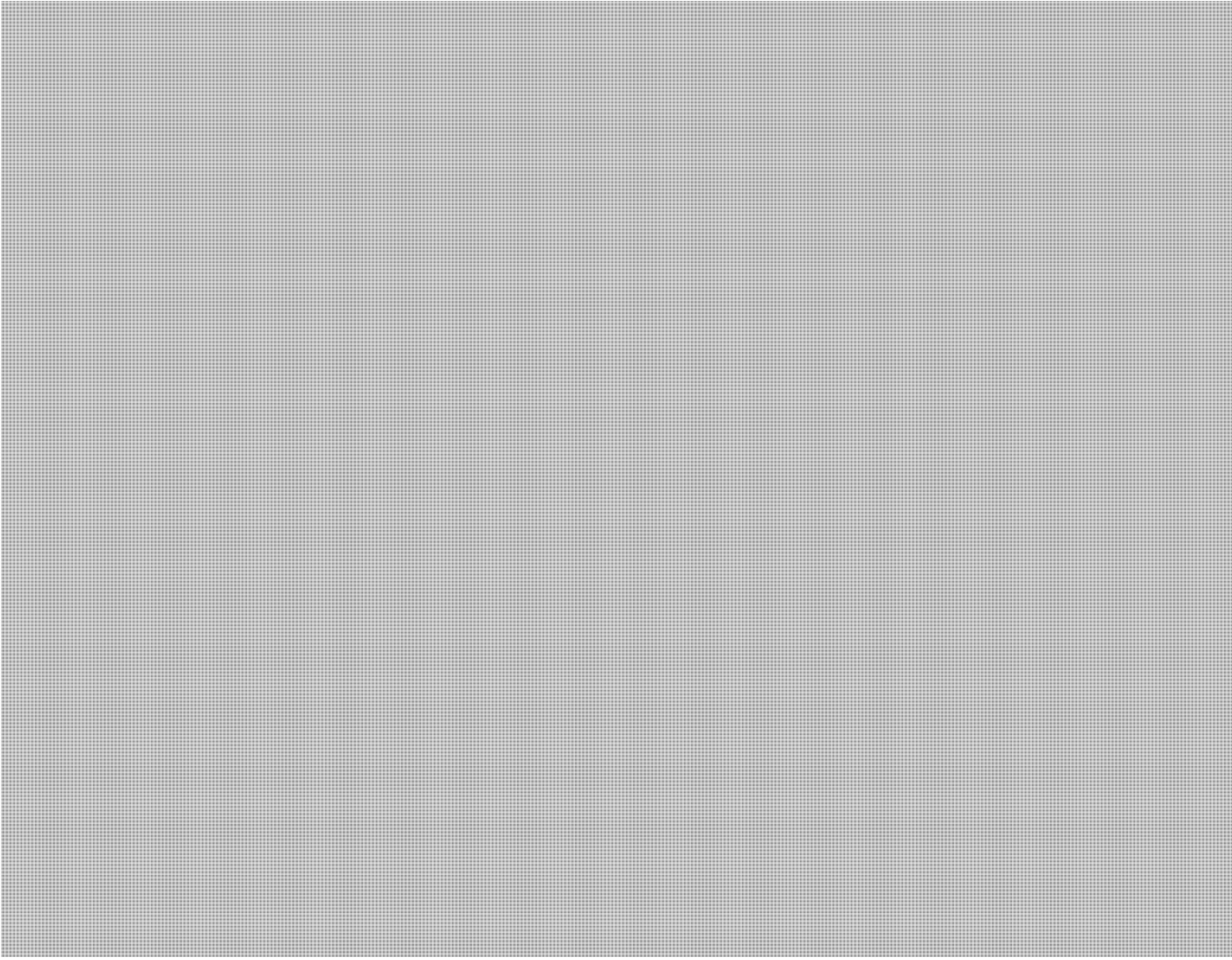
Mosley, Natalie (IC)

From: Mulligan, Jennifer (IC)
Sent: November-03-16 11:36 AM
To: Hudon, Christine (IC)
Subject: RE: [REDACTED]

Attachments: [REDACTED]


Salut Christine,

[REDACTED]



Jennifer Mulligan
Acting Paralegal / Parajuriste intérimaire
Innovation, Science and Economic Development Legal Services / Services juridiques d'Innovation, Sciences et
Développement économique
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235 Queen Street / 235 rue Queen
Ottawa, Ontario K1A 0H5
(343) 291-2277

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From: Hudon, Christine (IC)
Sent: November-02-16 12:08 PM
To: Mulligan, Jennifer (IC)
Subject: RE: 
law

Many thanks.

**Pages 15 to / à 54
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Mongelard, Pascal (IC)

De: Giassa, Natalie (IC)
Envoyé: 7 mars 2017 15:01
À: Mosley, Natalie (IC); Mongelard, Pascal (IC)
Objet: FW: [MARKETING] Top 10 Deals of 2016 | Trinity Western sparks fundamental debate | Lawyers play critical role in uncertain times

ATIP David Fewer

From: Canadian Legal Newswire [mailto:canadianlawyer@mail2.thomsonreuters.ca]
Sent: February-06-17 4:20 PM
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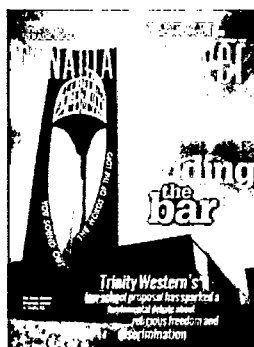


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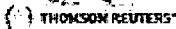
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In a statement, Edward Iacobucci, the university's dean of the Faculty of Law, said the law faculty has reached out to Canadian JD students in the U.S. who may want to transfer to U of T in the face of Trump's executive order, which imposes a temporary halt on citizens from seven majority-Muslim countries travelling to the U.S. Click [here](#) to read more of this story and other news tidbits in this week's Inside Story.



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Finding his stage

Canadian Lawyer

Michael Rubinoff is ebullient. The hit musical that was his brainchild, *Come From Away*, is playing to sold-out audiences in Toronto, and it will soon open in previews on Broadway. And for this Toronto lawyer, the transition from a legal career to theatrical producer and associate dean of Sheridan College's Visual and Performing Arts programs in Oakville, Ont. has been a fortuitous one.

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When are public documents too public?: A.T. v. Globe24h.com tests the limits

Canadian Lawyer, online

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Innovation needs diversity

Canadian Lawyer

General counsel to UFCW Canada and member of Legal Leaders for Diversity and Inclusiveness Naveen Mehta writes an essential, and often overlooked, component is that a diversity of voices from a variety of experiences and backgrounds can only be harnessed if those voices are given value, are heard and included in decision-making.



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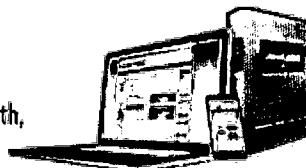
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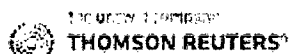
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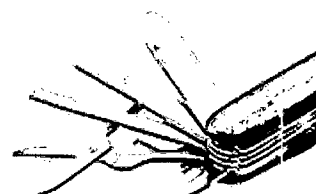
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Mosley, Natalie (IC)

Subject: FW: [MARKETING] Top 10 Deals of 2016 | Trinity Western sparks fundamental debate | Lawyers play critical role in uncertain times

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Innovation needs diversity

Canadian Lawyer

General counsel to UFCW Canada and member of Legal Leaders for Diversity and Inclusiveness Naveen Mehta writes an essential, and often overlooked, component is that a diversity of voices from a variety of experiences and backgrounds can only be harnessed if those voices are given value, are heard and included in decision-making.



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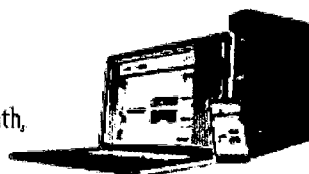
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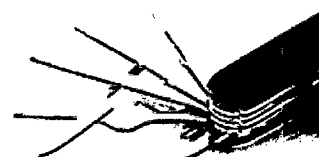
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**of the Access to Information Act
de la Loi sur l'accès à l'information**

Public document

Court File No.: T-1391-14

FEDERAL COURT

BETWEEN:

1395804 ONTARIO LTD., OPERATING AS BLACKLOCK'S REPORTER

Plaintiff

And

CANADA (ATTORNEY GENERAL)

Defendant

PRE-TRIAL CONFERENCE MEMORANDUM OF THE DEFENDANT

Date of Pre-Trial Conference: March 10, 2016 (Ottawa, Ontario)

Plaintiff: 1395804 Ontario Ltd, operating as
Blacklock's Reporter

Counsel for the Plaintiff: Yavar Hameed

Defendant: Attorney General of Canada

Counsel for the Defendant: Alexandre Kaufman
Sarah Sherhols

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TAB A

Court File Number: T-1391-14

FEDERAL COURT OF CANADA

BETWEEN:

1395804 Ontario Ltd, operating as Blacklock's Reporter

Plaintiff

-and-

ATTORNEY GENERAL OF CANADA

Defendant

**PRE-TRIAL CONFERENCE MEMORANDUM OF THE
DEFENDANT**

Date of Pre-Trial Conference: March 10, 2016 (Ottawa, Ontario)

Plaintiff: 1395804 Ontario Ltd, operating as
Blacklock's Reporter

Counsel for the Plaintiff: Yavar Hameed

Defendant: Attorney General of Canada

Counsel for the Defendant: Alexandre Kaufman
Sarah Sherhols

Pre-trial memorandum of the defendant

I. CONCISE STATEMENT OF THE NATURE OF THE PROCEEDINGS

1. The plaintiff is an online news outlet with a very limited distribution of about 260 licensees and paid subscribers. The market value of its content is low. The most it has charged for a yearly subscription to its publication is around \$2,600 for large organizations. Yet it seeks \$17,029.10¹ for breach of the *Copyright Act* [the "*Act*"] when a Department of Finance employee received two of its articles unsolicited, and shared them with at most six other employees for the purpose of correcting misleading and inaccurate statements.

2. The plaintiff's business depends on extracting settlements by asserting tenuous copyright infringement claims and threatening litigation. Numerous entities have settled with the plaintiff by paying for a subscription at an inflated cost rather than face costly litigation. The plaintiff has ten outstanding copyright infringement actions before this Court against federal departments and agencies. The plaintiff has also brought similar actions against non-government parties. As set out more fully below, the plaintiff's pattern of conduct constitutes copyright misuse and should be sanctioned.

3. Moreover, the purpose of the *Act* is to maintain a proper balance between a copyright owner's rights and users' interests. Fair dealing applies when copyrighted works are reproduced for one of the allowable purposes under the *Act*, namely research, private study, criticism, review or news reporting. The two articles in this

¹ The claim currently seeks \$17,816.71, however, at paragraph 7 of its pre-trial memorandum, the plaintiff seeks to admit and/or otherwise amend this amount to \$17,029.10.

Pre-trial memorandum of the defendant

case were shared for an allowable purpose and therefore did not infringe the plaintiff's copyright.

4. The issues for the Court are whether the defendant's sharing of the two articles breached the plaintiff's copyright and, if so, whether the defence of copyright misuse applies and what is the appropriate assessment of damages.

II. ADMISSIONS

5. The defendant admits that Finance employees shared two news articles. One of the two articles became publicly available on the plaintiff's website six weeks after it was published. At most, six officials saw the two articles. However, this sharing was neither a breach of the plaintiff's terms and conditions nor the *Act*.

III. THE FACTUAL AND LEGAL CONTENTIONS OF THE DEFENDANT

A. FACTUAL CONTENTIONS

1. Finance shared two articles among six people for the purpose of research, review and criticism

6. The plaintiff regularly requests and receives information from federal departments and agencies, such as Finance, to write its articles. Federal departments and agencies have media monitoring groups to ensure the accuracy of media articles concerning their activities.

7. The plaintiff wrote two articles on Finance's activities that misrepresented the facts. A third party, concerned about these misrepresentations, sent a Finance employee unsolicited emails forwarding the two articles. The third party did not notify Finance that the articles may be copyrighted, that they could not be shared, nor did she provide any other information about the terms of her subscription.

Pre-trial memorandum of the defendant

8. Finance shared these two articles among up to six of its employees to determine whether it needed to correct the misrepresentations in the articles.

2. The plaintiff demanded \$17,816.71 from Finance

9. The plaintiff learned that Finance shared the two articles among up to six Finance employees through a request it made under the *Access to Information Act*. The plaintiff subsequently invoiced Finance for alleged copyright breaches, demanding \$17,816.71. In response to this invoice, and without any admission of liability, Finance offered to resolve the matter for \$471.00. The plaintiff rejected this offer and when Finance did not pay its speculative invoice in full, the plaintiff started this litigation.

B. LEGAL CONTENTIONS

1. The defendant's sharing of two articles was fair dealing

10. The concept of fair dealing under section 29 of the *Act* maintains the proper balance between protection and access embodied by that Act. As an exception, fair dealing allows users to engage in activities that might otherwise constitute copyright infringement if those activities are "for the purpose of research or private study." This provision and the word "research" are to be given a broad interpretation that ensures that users' rights are not unduly restricted.²

11. The defendant's sharing of the two articles at issue was fair dealing and thus did not breach the *Act*. The two articles were about the defendant's activities, and misrepresented those activities. The defendant's sharing of these articles to know what was being said about it and to decide whether to respond to those misrepresentations

² *Society of Composers, Authors and Music Publishers of Canada v Bell Canada*, 2012 SCC 36 at para 11.

Pre-trial memorandum of the defendant

fell squarely within this exception.

2. The plaintiff's copyright trolling pattern

12. The term "copyright troll" is associated with plaintiffs who are "more focused on the business of litigation than on selling a product or service or licencing their IP to third parties to sell a product or service".³ A troll "either asserts rights it does not have, makes poorly substantiated claims or tenuous of infringement, or seeks disproportionate remedies."⁴ A troll does at least one of these things on a systemic basis.⁵

13. The defence of copyright misuse applies where a copyright holder attempts to extend his copyright in a way that violates the public policy embodied in copyright law. For example, where a copyright holder generates its revenue through speculative invoicing, demand letters and litigation.

14. In the last eighteen months, the plaintiff has brought ten actions against federal departments and agencies, and four actions against other organizations. These actions show a copyright trolling pattern of writing misleading or inaccurate articles about an organization with the expectation that these articles would be accessed and shared internally. The plaintiff then makes requests under the *Access to Information Act* for evidence of distribution, and then claims disproportionate damages through speculative invoices, demand letters and litigation.

15. In all of these actions, the plaintiff's claims of copyright infringement are

³ Matthew Sag, "Copyright Trolling, An Empirical Study" (2015) Iowa Law Review at 8-9.

⁴ *Ibid*, at p. 9.

⁵ *Ibid*.

Pre-trial memorandum of the defendant

tenuous. In this action, the plaintiff claims copyright infringement where a third party, who was a Blacklock's subscriber and is not a party to this action, sent the defendant two unsolicited articles. The defendant then used these articles misrepresenting the defendant's activities for the purposes of fair dealings.

3. The damages claimed are grossly inflated

16. As in all actions seeking monetary damages, a court in a copyright action is guided by the amount of actual damage suffered by a plaintiff. This is so whether the plaintiff seeks general damages, as is the case here, or statutory damages under section 38.1 of the *Act*. In either case, the court assesses damages based on the actual or potential losses flowing from the infringement. Accordingly, if the plaintiff regularly granted licenses at a certain rate, then this rate is the best evidence of the rate that the plaintiff would have agreed to and it should thus guide the assessment of damages.⁶

17. The plaintiff's business model depends on its copyright trolling pattern where high legal costs relative to the amounts claimed induce defendants to settle, regardless of the claim's merit. Indeed, the plaintiff has induced such settlements in at least eight instances, including: Agriculture and Agri-Food Canada; the Privy Council Office; Canada Mortgage and Housing Corporation; and the Canadian Museum of History. The revenues generated by these settlements represent a substantial percentage of the plaintiff's revenues.

18. In its pre-trial brief, the plaintiff claims that amounts it received from entities after it sent demand letters and accused them of copyright infringement were not

⁶ *Damages Calculations in Intellectual Property Cases in Canada*, Duff & Phelps, June 2012 at p. 22.

Pre-trial memorandum of the defendant

"settlements". The plaintiff relies on payments extracted under threat of litigation as evidence of its licence's fair market value.

19. The amounts claimed in this action (or any of the other actions before this court) do not reflect the terms upon which the plaintiff actually licenses its articles on a commercial basis, and is an artificially high amount that is unrelated to the actual value of its articles. The most the plaintiff has ever received for a license is around \$2,600, which represents only 15% of the amount claimed in this action.

Pre-trial memorandum of the defendant

IV. STATEMENT OF ISSUES TO BE DETERMINED AT TRIAL

20. The defendant submits that there will be four issues to be determined at trial:
- a. whether the defendant's use of the two articles was fair dealing under section 29 of the *Act*;
 - b. if the defendant's use was not fair dealing, whether the defendant breached the *Act* by sharing two unsolicited articles among six people within the Department of Finance;
 - c. if the defendant breached the *Act*, whether the plaintiff's claims should be dismissed under the defence of copyright misuse;
 - d. if the defendant breached the *Act* and the plaintiff's claims are not dismissed, what is the proper assessment of damages.

DATED AT OTTAWA, this 29th day of February 2016.


Alexandre Kaufman

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Counsel for the Defendant

TAB 1

Society of Composers, Authors and Music Publishers of Canada, Canadian Recording Industry Association and CMRRA-SODRAC Inc. *Appellants*

v.

Bell Canada, Apple Canada Inc., Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P., TELUS Communications Inc., Entertainment Software Association and Entertainment Software Association of Canada *Respondents*

and

Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic, Canadian Association of University Teachers, Canadian Legal Information Institute and Computer & Communications Industry Association *Interveners*

INDEXED AS: SOCIETY OF COMPOSERS, AUTHORS AND MUSIC PUBLISHERS OF CANADA v. BELL CANADA

2012 SCC 36

File No.: 33800.

2011: December 6; 2012: July 12.

Present: McLachlin C.J. and LeBel, Deschamps, Fish, Abella, Rothstein, Cromwell, Moldaver and Karakatsanis JJ.

ON APPEAL FROM THE FEDERAL COURT OF APPEAL

Intellectual property — Copyright — Infringement — Exception — Fair dealing — Online music service providers giving customers the ability to listen to free previews of musical works prior to purchase of musical works — Collective society seeking to collect royalties for use of previews — Whether the use of previews

Société canadienne des auteurs, compositeurs et éditeurs de musique, Association de l'industrie canadienne de l'enregistrement et CMRRA-SODRAC Inc. *Appelantes*

c.

Bell Canada, Apple Canada Inc., Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P., Société TELUS Communications, Entertainment Software Association et Association canadienne du logiciel de divertissement *Intimées*

et

Clinique d'intérêt public et de politique d'internet du Canada Samuelson-Glushko, Association canadienne des professeures et des professeurs d'université, Fédération des ordres professionnels de juristes du Canada, Institut canadien d'information juridique et Computer & Communications Industry Association *Intervenants*

RÉPERTOIRE : SOCIÉTÉ CANADIENNE DES AUTEURS, COMPOSITEURS ET ÉDITEURS DE MUSIQUE c. BELL CANADA

2012 CSC 36

N° du greffe : 33800.

2011 : 6 décembre; 2012 : 12 juillet.

Présents : La juge en chef McLachlin et les juges LeBel, Deschamps, Fish, Abella, Rothstein, Cromwell, Moldaver et Karakatsanis.

EN APPEL DE LA COUR D'APPEL FÉDÉRALE

Propriété intellectuelle — Droit d'auteur — Violation — Exception — Utilisation équitable — Services de musique en ligne offrant au consommateur, avant l'achat d'une œuvre musicale, la possibilité d'en écouter gratuitement un extrait — Société de gestion collective alléguant le droit de percevoir une redevance pour

2012 SCC 36 (CanLII)

constitutes "fair dealing" — *Copyright Act, R.S.C. 1985, c. C-42, s. 29.*

S represents composers, authors and music publishers and administers their performing and communication rights. S filed proposed tariffs with the Copyright Board for the determination of royalties to be paid when musical works are communicated to the public over the Internet. The Board agreed that S was entitled to collect royalties for the downloading of musical works but not for previews, which consist of 30- to 90-second excerpts of musical works that can be listened to by consumers prior to purchasing the work. In the Board's view, the use of previews was not an infringement of copyright since it was "fair dealing" for the purpose of research under s. 29 of the *Copyright Act*, and, accordingly, no royalties were required to be paid to S. The Federal Court of Appeal upheld the Board's decision.

Held: The appeal should be dismissed.

Fair dealing allows users to engage in activities that might otherwise amount to copyright infringement. The purpose of the fair dealing analysis under the *Copyright Act* is to determine whether the proper balance has been achieved between protection of the exclusive rights of authors and copyright owners and access to their works by the public.

The test for fair dealing was articulated in *CCH Canadian Ltd. v. Law Society of Upper Canada*, and involves two steps. The first step is to determine whether the dealing is for the purpose of either "research" or "private study", the two allowable purposes listed under s. 29 of the *Copyright Act*. The second step assesses whether the dealing is "fair".

The first inquiry in this case is whether the previews are provided for the allowable purpose of "research" under the first step of the fair dealing test. The purpose of "research" should be analyzed from the perspective of the consumer as the ultimate user, not the online service provider. The Board properly considered the previews from the perspective of the consumer's purpose, namely, conducting research to identify which music to purchase.

"Research" need not be for creative purposes only. Permitting only creative purposes to qualify as "research" would ignore the fact that one of the objectives of the *Copyright Act* is the dissemination of the works themselves. Limiting "research" to creative

l'écoute préalable d'un extrait — Cette écoute constitue-t-elle une « utilisation équitable »? — Loi sur le droit d'auteur, L.R.C. 1985, ch. C-42, art. 29.

S représente les compositeurs, les auteurs et les éditeurs de musique et elle gère leurs droits d'exécution et de communication. Elle a demandé à la Commission du droit d'auteur de fixer les redevances exigibles lors de la communication au public d'œuvres musicales sur Internet. La Commission a convenu que S pouvait percevoir une redevance pour le téléchargement d'une œuvre musicale, mais pas pour l'écoute préalable d'un extrait de celle-ci, d'une durée de 30 à 90 secondes, avant que le consommateur ne décide d'acheter l'œuvre ou non. À son avis, l'écoute préalable ne viole pas le droit d'auteur, car elle peut être assimilée à l'« utilisation équitable » aux fins de recherche que permet l'art. 29 de la *Loi sur le droit d'auteur* et, partant, elle n'emporte pas le versement de redevances à S. La Cour d'appel fédérale a confirmé la décision de la Commission.

Arrêt : Le pourvoi est rejeté.

L'utilisation équitable permet certaines activités qui, sans cette exception, pourraient violer le droit d'auteur. L'analyse y afférente fondée sur la *Loi sur le droit d'auteur* vise à déterminer si un juste équilibre a été établi entre la protection des droits exclusifs des auteurs et des titulaires du droit d'auteur et l'accès du public à leurs œuvres.

Énoncé dans l'arrêt *CCH Canadienne Ltée c. Barreau du Haut-Canada*, le critère relatif à l'utilisation équitable comporte deux volets. Dans le cadre du premier, il s'agit de savoir si l'utilisation a pour but la « recherche » ou l'« étude privée », les deux seules fins expressément prévues à l'art. 29 de la *Loi sur le droit d'auteur*. Le second volet s'attache à déterminer si l'utilisation est « équitable ».

Suivant le premier volet du critère relatif à l'utilisation équitable, il faut d'abord se demander en l'espèce si les extraits sont offerts à la fin permise de « recherche ». Le bon angle d'analyse n'est alors pas celui du fournisseur de services en ligne, car il faut considérer la situation du point de vue du consommateur en tant qu'utilisateur ultime. La Commission a dûment considéré les extraits en fonction de la fin poursuivie par le consommateur, soit la recherche de pièces musicales à acquérir.

Une fin de « recherche » ne s'entend pas seulement d'une fin créative. Conclure en ce sens serait oublier que la diffusion des œuvres constitue l'un des objectifs de la *Loi sur le droit d'auteur*. Ce serait également contraire au sens ordinaire du mot « recherche » auquel

purposes would also run counter to the ordinary meaning of "research", which includes many activities that do not require the establishment of new facts or conclusions. The fair dealing exception must not be interpreted restrictively and "research" must be given a large and liberal interpretation.

The inquiry then moves to the second step set out in *CCH*, namely, determining whether the use of previews was "fair". The factors to be considered in determining whether a dealing is fair are the purpose, character, and amount of the dealing; the existence of any alternatives to the dealing; the nature of the work; and the effect of the dealing on the work.

The Board properly concluded that previews constituted fair dealing. The guiding perspective is that of the ultimate user or consumer. The service providers facilitate the research purposes of the consumers. There are reasonable safeguards in place to ensure that the previews are being used for this purpose.

With respect to the character of the dealing, users do not keep a permanent copy of the preview, since the file is streamed and automatically deleted from the user's computer once the preview is heard. As a result, copies cannot be duplicated or further disseminated.

The "amount of the dealing" factor should not be assessed on the basis of the aggregate number of previews that are streamed by consumers. This factor should be assessed by looking at the proportion of the preview in relation to the whole work, not the aggregate amount of music heard through previews. Streaming a preview of several seconds is a modest amount when compared to the whole work.

Under the remaining factors, there are no alternatives to the dealing that as effectively demonstrate to a consumer what a musical work sounds like. Previews are therefore reasonably necessary to help consumers research what to purchase. Unless a potential customer can locate and identify the work he or she wants to buy, the work will not be disseminated. Short, low-quality previews do not compete with, or adversely affect, the downloading of the works themselves. Instead, their effect is to increase the sale and dissemination of copyrighted musical works.

The previews therefore constitute fair dealing under the *Copyright Act*.

on associe de nombreuses activités qui n'exigent pas l'établissement de faits nouveaux ou la formulation de conclusions nouvelles. Il ne faut pas interpréter restrictivement l'utilisation équitable, et le mot « recherche » doit être interprété de manière large et généreuse.

Au deuxième volet du critère de l'arrêt *CCH*, il faut déterminer si l'écoute préalable constitue une utilisation « équitable ». Les éléments à considérer sont alors le but, la nature et l'ampleur de l'utilisation; l'existence de solutions de rechange à l'utilisation; la nature de l'œuvre; et l'effet de l'utilisation sur l'œuvre.

La Commission a conclu avec raison que l'écoute préalable constituait une utilisation équitable. Le point de vue qu'il convient d'adopter est celui de l'utilisateur final, le consommateur. Le fournisseur de services facilite la recherche, la fin que poursuit le consommateur, et des mesures garantissent raisonnablement que l'écoute préalable a lieu à cette fin.

En ce qui a trait à la nature de l'utilisation, l'utilisateur n'obtient pas de copie permanente; le fichier transmis en continu est en effet supprimé automatiquement dans l'ordinateur de l'utilisateur une fois l'écoute terminée, ce qui exclut toute reproduction ou nouvelle diffusion.

Il ne faut pas apprécier l'élément « ampleur de l'utilisation » au regard du nombre total d'extraits écoutés par les consommateurs grâce à la transmission en continu. C'est à l'aune du rapport entre l'extrait et l'œuvre entière qu'il faut apprécier cet élément, et non en fonction de la quantité globale de musique écoutée grâce aux extraits. La transmission en continu d'un extrait de quelques secondes constitue une utilisation modeste par rapport à l'œuvre en entier.

En ce qui concerne les autres éléments, aucune solution de rechange à l'utilisation ne donne au consommateur une aussi bonne idée de la teneur de l'œuvre musicale. L'écoute préalable constitue donc un moyen raisonnablement nécessaire à la recherche par le consommateur de ce qu'il souhaite acquérir. Il n'y aura diffusion d'une œuvre que si un acquéreur éventuel peut la trouver puis décider de l'acheter. Étant donné leur courte durée et leur piètre qualité, les extraits ne font pas concurrence au téléchargement des œuvres elles-mêmes et ils n'ont pas d'effet préjudiciable sur elles. En fait, ils augmentent la vente et la diffusion d'œuvres musicales protégées par le droit d'auteur.

L'écoute préalable constitue donc une utilisation équitable pour l'application de la *Loi sur le droit d'auteur*.

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Henry Brown, Q.C., Gilles M. Daigle, Paul Spurgeon and Matthew S. Estabrooks, for the

Jurisprudence

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POURVOI contre un arrêt de la Cour d'appel fédérale (les juges Létourneau, Nadon et Pelletier), 2010 CAF 123, 403 N.R. 57, 320 D.L.R. (4th) 342, 83 C.P.R. (4th) 409, [2010] A.C.F. n° 570 (QL), 2010 CarswellNat 1334, qui a confirmé une décision de la Commission du droit d'auteur, www.cb-cda.gc.ca/decisions/2007/20071018-m-e.pdf, (2007), 61 C.P.R. (4th) 353, [2007] D.C.D.A. n° 7 (QL), 2007 CarswellNat 3467. Pourvoi rejeté.

Henry Brown, c.r., Gilles M. Daigle, Paul Spurgeon et Matthew S. Estabrooks, pour

appellant the Society of Composers, Authors and Music Publishers of Canada.

Glen A. Bloom, for the appellant the Canadian Recording Industry Association.

Casey M. Chisick, Timothy Pinos and Jason Beitchman, for the appellant CMRRA-SODRAC Inc.

Gerald L. Kerr-Wilson, Ariel A. Thomas and Julia Kennedy, for the respondents Bell Canada, Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P. and TELUS Communications Inc.

Michael Koch, for the respondent Apple Canada Inc.

No one appeared for the respondents the Entertainment Software Association and the Entertainment Software Association of Canada.

David Fewer and Jeremy de Beer, for the intervener the Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic.

Wendy Matheson, Andrew Bernstein and Alexandra Peterson, for the intervener the Canadian Association of University Teachers.

Ronald E. Dimock and Sangeetha Punniyamoorthy, for the interveners the Federation of Law Societies of Canada and the Canadian Legal Information Institute.

Andrea Rush, for the intervener the Computer & Communications Industry Association.

The judgment of the Court was delivered by

[1] ABELLA J. — The purchase of musical works is increasingly carried out over the Internet. Some commercial Internet sites that sell music allow consumers to preview musical works before making a purchase. The issue in this case is whether those

l'appelante la Société canadienne des auteurs, compositeurs et éditeurs de musique.

Glen A. Bloom, pour l'appelante l'Association de l'industrie canadienne de l'enregistrement.

Casey M. Chisick, Timothy Pinos et Jason Beitchman, pour l'appelante CMRRA-SODRAC Inc.

Gerald L. Kerr-Wilson, Ariel A. Thomas et Julia Kennedy, pour les intimées Bell Canada, Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P. et Société TELUS Communications.

Michael Koch, pour l'intimée Apple Canada Inc.

Personne n'a comparu pour les intimées Entertainment Software Association et l'Association canadienne du logiciel de divertissement.

David Fewer et Jeremy de Beer, pour l'intervenante la Clinique d'intérêt public et de politique d'internet du Canada Samuelson-Glushko.

Wendy Matheson, Andrew Bernstein et Alexandra Peterson, pour l'intervenante l'Association canadienne des professeures et des professeurs d'université.

Ronald E. Dimock et Sangeetha Punniyamoorthy, pour les intervenants la Fédération des ordres professionnels de juristes du Canada et l'Institut canadien d'information juridique.

Andrea Rush, pour l'intervenante Computer & Communications Industry Association.

Version française du jugement de la Cour rendu par

[1] LA JUGE ABELLA — Les gens font de plus en plus l'acquisition d'œuvres musicales sur Internet. Certains sites commerciaux de vente en ligne leur permettent d'écouter un extrait d'une œuvre musicale avant de décider de se la procurer ou non. En

previews constitute “fair dealing” under s. 29 of the *Copyright Act*, R.S.C. 1985, c. C-42.

Background

[2] The Society of Composers, Authors and Music Publishers of Canada (SOCAN) represents composers, authors and music publishers and administers their performing and communication rights. Its arguments before this Court were supported by the Canadian Recording Industry Association and CMRRA-SODRAC Inc.

[3] Bell Canada, Apple Canada Inc., Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P. and TELUS Communications Inc. operate online music services that sell downloads of digital files of musical works. These services provide catalogues of digital audio files that allow users to identify musical works by title, album, genre and artist. The service providers also give consumers the ability to listen to free “previews” of those works before deciding which work to purchase. SOCAN seeks compensation for the provision of those previews over and beyond what would normally be paid for a music download or a CD.

[4] A preview consists of an extract taken from the work, usually 30 to 90 seconds of a musical track. Users are able to select and listen to the preview through an online “stream”, meaning that a temporary copy of the excerpt is heard by the user in such a way that his or her computer does not store a permanent copy of the preview. The previews help users decide whether to purchase a permanent download of the work. Apple’s iTunes service, for example, allows consumers to listen to previews as many times as they want, whether or not they make a purchase or have registered with the online service provider.

[5] As noted in the companion appeal (*Rogers Communications Inc. v. Society of Composers, Authors and Music Publishers of Canada*, [2012]

l’espèce, la question à trancher est celle de savoir si l’« utilisation équitable » visée à l’art. 29 de la *Loi sur le droit d’auteur*, L.R.C. 1985, ch. C-42, peut s’entendre de cette écoute préalable.

Contexte

[2] La Société canadienne des auteurs, compositeurs et éditeurs de musique (SOCAN) représente les compositeurs, les auteurs et les éditeurs de musique et elle gère par ailleurs leurs droits d’exécution et de communication. La thèse qu’elle défend devant nous reçoit l’appui de l’Association de l’industrie canadienne de l’enregistrement et de CMRRA-SODRAC Inc.

[3] Bell Canada, Apple Canada Inc., Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P. et Société TELUS Communications exploitent des services de musique en ligne qui vendent le téléchargement de fichiers audionumériques. Leurs catalogues proposent des œuvres musicales classées par titre de piste ou d’album, genre ou artiste. Le consommateur peut, avant de décider d’acheter une œuvre ou non, en écouter gratuitement un extrait. La SOCAN demande qu’une somme soit exigible pour l’écoute d’un tel extrait en sus de ce qui est normalement versé pour l’obtention d’un téléchargement ou d’un disque compact.

[4] Généralement, l’extrait de la piste musicale dure de 30 à 90 secondes. L’utilisateur peut choisir la pièce et écouter l’extrait grâce à une transmission en continu, de sorte qu’il a accès à une copie temporaire qu’il ne peut conserver de manière permanente dans son ordinateur. L’écoute préalable guide l’utilisateur dans sa décision d’acheter ou non un téléchargement permanent de l’œuvre. Par exemple, grâce au service iTunes d’Apple, le consommateur peut écouter un extrait autant de fois qu’il le veut, sans obligation d’achat de sa part ni obligation d’être inscrit auprès du fournisseur en ligne.

[5] Comme il est précisé dans le pourvoi connexe (*Rogers Communications Inc. c. Société canadienne des auteurs, compositeurs et éditeurs*

2 S.C.R. 283), SOCAN filed proposed tariffs targeting the years 1996 to 2006 with the Copyright Board of Canada in 1995 for the determination of royalties to be paid by users when musical works are communicated to the public over the Internet.

[6] In a decision released on October 18, 2007 (61 C.P.R. (4th) 353), the Board agreed that SOCAN was entitled to collect royalties for the downloading of musical works, but not for previews. In the Board's view, the use of previews was not an infringement of copyright since their use was "fair dealing" for the purpose of research under s. 29 of the *Copyright Act* based on the factors identified by McLachlin C.J. in *CCH Canadian Ltd. v. Law Society of Upper Canada*, [2004] 1 S.C.R. 339. Because the previews were not an infringement of copyright, no royalties were required to be paid to SOCAN for their use.

[7] The Federal Court of Appeal upheld the Board's decision (2010 FCA 123, 403 N.R. 57). As would I.

Analysis

[8] In *Théberge v. Galerie d'Art du Petit Champlain inc.*, [2002] 2 S.C.R. 336, this Court noted that copyright requires "a balance between promoting the public interest in the encouragement and dissemination of works of the arts and intellect and obtaining a just reward for the creator" (para. 30).

[9] *Théberge* reflected a move away from an earlier, author-centric view which focused on the exclusive right of authors and copyright owners to control how their works were used in the marketplace: see e.g. *Bishop v. Stevens*, [1990] 2 S.C.R. 467, at pp. 478-79. Under this former framework, any benefit the public might derive from the copyright system was only "a fortunate by-product of private entitlement": Carys J. Craig, "Locke, Labour and Limiting the Author's Right: A Warning against a

de musique, [2012] 2 R.C.S. 283), en 1995, la SOCAN a demandé à la Commission du droit d'auteur du Canada de fixer les redevances exigibles des utilisateurs pour les années 1996 à 2006 lors de la communication au public d'œuvres musicales sur Internet.

[6] Dans sa décision du 18 octobre 2007 (en ligne), la Commission a convenu que la SOCAN pouvait à bon droit percevoir des redevances pour le téléchargement d'œuvres musicales, mais pas pour l'écoute préalable. À son avis, l'écoute préalable ne violait pas le droit d'auteur, car elle pouvait être assimilée à l'« utilisation équitable » aux fins de recherche que permet l'art. 29 de la *Loi sur le droit d'auteur* compte tenu des éléments énoncés par la juge en chef McLachlin dans l'arrêt *CCH Canadienne Ltée c. Barreau du Haut-Canada*, [2004] 1 R.C.S. 339. L'écoute d'extraits ne constituant pas une violation du droit d'auteur, elle n'emportait pas le versement de redevances à la SOCAN.

[7] La Cour d'appel fédérale a confirmé la décision de la Commission (2010 CAF 123 (CanLII)), et j'abonde dans le même sens.

Analyse

[8] Dans l'arrêt *Théberge c. Galerie d'Art du Petit Champlain inc.*, [2002] 2 R.C.S. 336, la Cour signale que l'application du droit d'auteur commande « un équilibre entre, d'une part, la promotion, dans l'intérêt du public, de la création et de la diffusion des œuvres artistiques et intellectuelles et, d'autre part, l'obtention d'une juste récompense pour le créateur » (par. 30).

[9] Dans cet arrêt, la Cour rompt avec une conception jusque-là centrée sur l'auteur de l'œuvre ainsi que sur le droit exclusif de l'auteur et du titulaire du droit d'auteur de décider de l'usage qui peut être fait de l'œuvre sur le marché : voir p. ex. *Bishop c. Stevens*, [1990] 2 R.C.S. 467, p. 478-479. Pour les tenants de cette conception, tout avantage que pouvait tirer le public du régime de protection du droit d'auteur ne représentait qu'une [TRADUCTION] « conséquence heureuse mais

Lockean Approach to Copyright Law" (2002), 28 *Queen's L.J.* 1, at pp. 14-15.

fortuite de la reconnaissance d'un droit privé » : Carys J. Craig, « Locke, Labour and Limiting the Author's Right : A Warning against a Lockean Approach to Copyright Law » (2002), 28 *Queen's L.J.* 1, p. 14-15.

[10] *Théberge* focused attention instead on the importance copyright plays in promoting the public interest, and emphasized that the dissemination of artistic works is central to developing a robustly cultured and intellectual public domain. As noted by Professor David Vaver, both protection and access must be sensitively balanced in order to achieve this goal: *Intellectual Property Law: Copyright, Patents, Trade-marks* (2nd ed. 2011), at p. 60.

[10] Dans l'arrêt *Théberge*, la Cour s'attache plutôt à l'importance du droit d'auteur lorsqu'il s'agit de promouvoir l'intérêt public et elle souligne que la diffusion des œuvres artistiques joue un rôle crucial dans l'établissement d'un domaine public vigoureux sur les plans culturel et intellectuel. Le professeur David Vaver fait observer que, à cette fin, un équilibre judicieux s'impose entre, d'une part, la protection des œuvres et, d'autre part, l'accès à ces dernières : *Intellectual Property Law : Copyright, Patents, Trade-marks* (2^e éd. 2011), p. 60.

[11] *CCH* confirmed that users' rights are an essential part of furthering the public interest objectives of the *Copyright Act*. One of the tools employed to achieve the proper balance between protection and access in the *Act* is the concept of fair dealing, which allows users to engage in some activities that might otherwise amount to copyright infringement. In order to maintain the proper balance between these interests, the fair dealing provision "must not be interpreted restrictively": *CCH*, at para. 48.

[11] L'arrêt *CCH* confirme que les droits des utilisateurs sont essentiels à la réalisation des objectifs de la *Loi* sur le droit d'auteur qui sont liés à l'intérêt public. L'exception au titre de l'utilisation équitable constitue l'un des moyens retenus par le législateur pour établir un juste équilibre entre protection et accès. Certaines activités qui, sans cette exception, pourraient violer le droit d'auteur, sont ainsi permises. Dès lors, pour maintenir un juste équilibre entre ces intérêts, « il ne faut pas [...] interpréter [l'exception] restrictivement » (*CCH*, par. 48).

[12] *CCH* sets out the test for fair dealing under s. 29 of the *Copyright Act*:

[12] Dans *CCH*, la Cour énonce le critère permettant de déterminer si une utilisation est équitable pour l'application de l'exception prévue à l'art. 29 de la *Loi sur le droit d'auteur*, dont voici le libellé :

29. Fair dealing for the purpose of research or private study does not infringe copyright.

29. L'utilisation équitable d'une œuvre ou de tout autre objet du droit d'auteur aux fins d'étude privée ou de recherche ne constitue pas une violation du droit d'auteur.

While not specifically in issue in the case before us, ss. 29.1 and 29.2 of the *Act* also permit "fair dealing" for the purposes of criticism, review or news reporting.

Les articles 29.1 et 29.2 de la *Loi*, dont l'application n'est pas précisément en jeu en l'espèce, permettent également une « utilisation équitable » aux fins de critique, de compte rendu ou de communication de nouvelles.

[13] The test for fair dealing articulated in *CCH* involves two steps. The first is to determine whether

[13] Le critère établi dans *CCH* relativement à l'utilisation équitable comporte deux volets.

the dealing is for the purpose of either “research” or “private study”, the two allowable purposes listed under s. 29. The second step assesses whether the dealing is “fair”. The onus is on the person invoking “fair dealing” to satisfy both aspects of the test under *CCH*.

[14] To assist in determining whether the dealing is “fair”, this Court set out the following six fairness factors for guidance: the purpose, character, and amount of the dealing; the existence of any alternatives to the dealing; the nature of the work; and the effect of the dealing on the work.

[15] The first inquiry in this case, therefore, is whether previews are provided for the allowable purpose of “research” under the first step of the *CCH* fair dealing test. While *CCH* did not define the word “research”, it notably concluded that “[r]esearch” must be given a large and liberal interpretation in order to ensure that users’ rights are not unduly constrained” (para. 51).

[16] The Board defined “previews” as

a marketing tool offered by online music services, among others. A preview is an excerpt (usually 30 seconds or less) of a sound recording that can be streamed so that consumers are allowed to “preview” the recording to help them decide whether to purchase a (usually permanent) download. [para. 18]

[17] Based on the evidence it heard about the purpose of previews and the way they were used by consumers, the Board concluded that “previews were used “either to determine whether the track suits the user’s tastes or to verify that the track is the one the user wants to buy” (para. 101). Listening to previews helped users identify what music to purchase. Since planning the purchase of a download involved “searching [and] investigation”, the Board was of the view that previews amounted to “research” under s. 29 of the *Copyright Act* (para. 109).

[18] The Federal Court of Appeal endorsed the Board’s view that listening to previews was part

Premièrement, l’utilisation a-t-elle pour but l’« étude privée » ou la « recherche », les deux fins permises à l’art. 29? Deuxièmement, l’utilisation est-elle « équitable »? Il incombe à la personne qui invoque l’« utilisation équitable » de satisfaire aux deux volets.

[14] Selon la Cour, les six éléments suivants permettent de déterminer si une utilisation est « équitable » ou non : le but, la nature et l’ampleur de l’utilisation; l’existence de solutions de rechange à l’utilisation; la nature de l’œuvre; et l’effet de l’utilisation sur l’œuvre.

[15] En l’espèce, le premier volet du critère relatif à l’utilisation équitable que dégage la Cour dans *CCH* veut donc qu’on se demande d’abord si les extraits sont offerts à l’une des deux fins permises, la « recherche ». La Cour ne définit pas ce mot, mais elle conclut qu’« [i]l faut interpréter le mot “recherche” de manière large afin que les droits des utilisateurs ne soient pas indûment restreints » (par. 51).

[16] La Commission définit l’« écoute préalable » comme suit :

... un moyen de mise en marché utilisé entre autres par les fournisseurs de musique en ligne. Il implique la transmission sur demande d’un extrait (habituellement d’au plus 30 secondes) d’un enregistrement sonore afin de permettre à l’utilisateur de l’« essayer », de façon à décider d’acheter ou non un téléchargement (la plupart du temps permanent). [par. 18]

[17] Au vu de la preuve présentée concernant la fin poursuivie lors de l’écoute préalable et le recours à celle-ci par les consommateurs, la Commission conclut que l’écoute d’extraits sert à « établir si la piste convient [à leurs] goûts [. . .] ou à vérifier si c’est bien celle qu’il[s] souhaite[nt] acheter » (par. 101). L’écoute préalable aide l’utilisateur à déterminer quelle pièce musicale il se procurera. Puisque planifier l’achat d’un téléchargement requiert à la fois « recherche [et] effort pour trouver », elle estime que l’écoute préalable équivaut à une « recherche » pour l’application de l’art. 29 de la *Loi sur le droit d’auteur* (par. 109).

[18] La Cour d’appel fédérale adhère au point de vue de la Commission, à savoir que l’écoute

of planning the purchase of a download of a musical work and was therefore “for the purpose of research”, concluding:

... it would not be unreasonable to give the word “research” its primary and ordinary meaning. The consumer is searching for an object of copyright that he or she desires and is attempting to locate and wishes to ensure its authenticity and quality before obtaining it. ... “[L]istening to previews assists in this investigation”. [para. 20]

[19] SOCAN argued that the Board and the Federal Court of Appeal misinterpreted the term “research” in two ways. It argued first that their interpretation of “research” was overly broad. Its second argument was that the purpose of “research” should have been analysed from the perspective of the online service provider and not the consumer. From this perspective, the purpose of the previews was not “research”, but to sell permanent downloads of the musical works.

[20] SOCAN offers the definition of “research” as being “the systematic investigation into and study of materials and sources in order to establish facts and reach new conclusions” (A.F., at para. 96). Moreover, SOCAN argues, the goal of the “research” must be for the purpose of making creative works, since only uses that contribute to the creative process are in the public interest. As a result, previews do not amount to “research” since their primary purpose is not to foster creativity, but to enable users to purchase music online.

[21] It is true that an important goal of fair dealing is to allow users to employ copyrighted works in a way that helps them engage in their own acts of authorship and creativity: Abraham Drassinower, “Taking User Rights Seriously”, in Michael Geist, ed., *In the Public Interest: The Future of Canadian Copyright Law* (2005), 462, at pp. 467-72. But that does not argue for permitting only creative purposes to qualify as “research” under s. 29 of the *Copyright Act*. To do so would ignore the fact that the dissemination of works is also one of the Act’s

préalable intervient dans la planification de l’achat du téléchargement d’une œuvre musicale et, par conséquent, « aux fins [...] de recherche ». Elle arrive à la conclusion suivante :

... il n’est pas déraisonnable de donner au mot « recherche » son sens premier et usuel. Car le consommateur est à la recherche d’un objet du droit d’auteur qu’il désire et s’efforce de trouver et dont il veut s’assurer de [l’]authenticité et de [la] qualité avant de se le procurer. [...] « [L]’écoute préalable contribue à cet effort pour trouver ». [par. 20]

[19] Selon la SOCAN, la Commission et la Cour d’appel fédérale interprètent mal le mot « recherche », et ce, sous deux rapports. Premièrement, elles optent pour une interprétation trop large. Deuxièmement, l’objet de la « recherche » aurait dû être considéré du point de vue du fournisseur de services en ligne, et non du consommateur. En effet, dans l’optique du premier, le but de l’écoute préalable n’est pas la « recherche », mais bien la vente du téléchargement permanent de l’œuvre musicale.

[20] Pour la SOCAN, la « recherche » s’entend de [TRADUCTION] « l’enquête et l’étude systématiques de documents et de sources en vue d’établir des faits et de tirer des conclusions nouvelles » (m.a., par. 96). En outre, la « recherche » devrait avoir pour but la conception d’œuvres créatives, car seule l’utilisation qui contribue au processus de création est dans l’intérêt public. Par conséquent, l’écoute préalable, dont le but principal n’est pas de favoriser la créativité mais de permettre à l’utilisateur d’acheter de la musique en ligne, ne saurait être assimilée à la « recherche ».

[21] Certes, l’un des objets importants de l’utilisation équitable des œuvres protégées est de permettre à d’autres personnes d’accomplir elles-mêmes des actes d’expression et de création : Abraham Drassinower, « Taking User Rights Seriously », dans Michael Geist, dir., *In the Public Interest : The Future of Canadian Copyright Law* (2005), 462, p. 467-472. Pour autant, on ne saurait considérer que seule une fin créative constitue une fin de « recherche » pour l’application de l’art. 29 de la *Loi sur le droit d’auteur*, car ce serait oublier que la diffusion

purposes, which means that dissemination too, with or without creativity, is in the public interest. It would also ignore that “private study”, a concept that has no intrinsic relationship with creativity, was also expressly included as an allowable purpose in s. 29. Since “research” and “private study” both qualify as fair dealing purposes under s. 29, we should not interpret the term “research” more restrictively than “private study”.

[22] Limiting research to creative purposes would also run counter to the ordinary meaning of “research”, which can include many activities that do not demand the establishment of new facts or conclusions. It can be piecemeal, informal, exploratory, or confirmatory. It can in fact be undertaken for no purpose except personal interest. It is true that research can be for the purpose of reaching new conclusions, but this should be seen as only one, not the primary component of the definitional framework.

[23] In urging the Court to narrow the definition of “research” as requiring the creation of something new, SOCAN relied on American jurisprudence which looks to the requirement of a “transformative” purpose before the use is seen as fair. It cited as an example *United States v. American Society of Composers, Authors and Publishers*, 599 F.Supp.2d 415 (2009), where the New York District Court held that the use of music previews as a marketing tool to sell musical ringtones was not “transformative” in nature and therefore could not be fairly described as “criticism, comment, news reporting . . . or research” under the fair use provisions in Title 17, § 107 of the *U.S. Code*, at pp. 424-25.

[24] The American approach is called “fair use”. The U.S. Code provisions create an open set of purposes for fair use which include criticism,

des œuvres fait également partie des objets de la *Loi*; dès lors, la diffusion — avec ou sans créativité — est aussi dans l'intérêt public. Opter pour une telle interprétation restrictive serait également oublier que l'« étude privée » — une notion sans lien intrinsèque avec la créativité — constitue aussi une fin expressément permise à l'art. 29. La « recherche » et l'« étude privée » constituant deux fins de l'utilisation équitable permise par cette disposition, il ne convient pas d'interpréter la première plus étroitement que la seconde.

[22] Rendre la « recherche » tributaire de la poursuite d'une fin créative serait également contraire à son sens ordinaire, car on peut y associer nombre d'activités qui ne consistent pas nécessairement à établir des faits nouveaux ou à tirer des conclusions nouvelles. La recherche peut être fragmentaire, informelle, exploratoire ou confirmative. Elle peut même être entreprise pour aucun autre motif que l'intérêt personnel. La recherche peut assurément avoir pour but d'arriver à des conclusions nouvelles, mais ce n'est qu'un de ses composants définitionnels, non le principal.

[23] À l'appui de sa prétention selon laquelle le mot « recherche » doit être interprété étroitement de façon à n'englober que la création d'un objet nouveau, la SOCAN invoque la jurisprudence américaine qui ne conclut au caractère équitable d'une utilisation que si celle-ci a une fin « transformative ». Elle cite à titre d'exemple la décision *United States v. American Society of Composers, Authors and Publishers*, 599 F.Supp. 2d 415 (2009), dans laquelle la Cour de district de New York conclut que l'écoute préalable qui sert de moyen de mise en marché en vue de la vente de sonneries musicales pour téléphones portables n'est pas de nature [TRADUCTION] « transformative » et ne saurait donc être assimilée à une forme « de critique, de commentaire, de reportage, [. . .] ou de recherche » pour les besoins des dispositions du titre 17 relatives à l'utilisation équitable (§ 107, *U.S. Code*, p. 424-425).

[24] Aux États-Unis, les dispositions relatives à l'utilisation équitable permettent des fins dont l'énumération n'est pas exhaustive; mentionnons la

comment, news reporting, teaching, scholarship, or research: 17 U.S.C. § 107. The analysis proceeds straight to the assessment of fairness, an assessment based on factors enumerated in the Code or established by the case law. Although one of those fairness factors includes whether the use is transformative, it is not at all clear that a transformative use is “absolutely necessary” for a finding of fair use: *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569 (1994), at p. 579.

[25] But even if it were a requirement under American law, this Court has previously cautioned against the automatic portability of American copyright concepts into the Canadian arena, given the “fundamental differences” in the respective legislative schemes: *Compo Co. v. Blue Crest Music Inc.*, [1980] 1 S.C.R. 357, at p. 367. This caution has resonance in the fair dealing context.

[26] Unlike the American approach of proceeding straight to the fairness assessment, we do not engage in the fairness analysis in Canada until we are satisfied that the dealing is for one of the allowable purposes enumerated in the *Copyright Act*. Under the test set out in *CCH*, “fairness” is not considered until the second step of the test for fair dealing: see *CCH*, at para. 51; see also Giuseppina D’Agostino, “Healing Fair Dealing? A Comparative Copyright Analysis of Canada’s Fair Dealing to U.K. Fair Dealing and U.S. Fair Use” (2008), 53 *McGill L.J.* 309, and *Century 21 Canada Limited Partnership v. Rogers Communications Inc.*, 2011 BCSC 1196, 338 D.L.R. (4th) 32, at para. 234.

[27] In mandating a generous interpretation of the fair dealing purposes, including “research”, the Court in *CCH* created a relatively low threshold for the first step so that the analytical heavy-hitting is done in determining whether the dealing was fair. SOCAN’s submission that “research”

critique, le commentaire, la communication de nouvelles, l’enseignement, les travaux d’érudition et la recherche : 17 U.S.C. § 107. On s’y livre d’emblée à la détermination du caractère équitable ou non de l’utilisation au regard des éléments établis par le législateur ou issus de la jurisprudence. Même si l’un de ces éléments correspond à la nature transformative ou non de l’utilisation, il n’est pas du tout certain que cette nature transformative soit [TRADUCTION] « absolument nécessaire » pour que l’on puisse conclure au caractère équitable de l’utilisation : *Campbell c. Acuff-Rose Music, Inc.*, 510 U.S. 569 (1994), p. 579.

[25] Or, même s’il s’agissait d’une exigence en droit américain, notre Cour a déjà mis en garde contre l’importation automatique, dans l’arène canadienne, de la jurisprudence fondée sur la conception américaine du droit d’auteur, car nos lois respectives sont « fondamentalement différentes » : *Compo Co. c. Blue Crest Music Inc.*, [1980] 1 R.C.S. 357, p. 367. La mise en garde trouve écho dans le contexte de l’utilisation équitable.

[26] Contrairement aux tribunaux américains qui passent directement à l’appréciation du caractère équitable, les tribunaux canadiens déterminent d’abord s’il y a utilisation à l’une des fins permises dans la *Loi sur le droit d’auteur* avant de se pencher sur le caractère équitable. Suivant les paramètres établis dans l’arrêt *CCH*, l’examen du caractère « équitable » correspond au second volet du critère applicable pour déterminer s’il y a utilisation équitable : voir *CCH*, par. 51; voir également Giuseppina D’Agostino, « Healing Fair Dealing? A Comparative Copyright Analysis of Canada’s Fair Dealing to U.K. Fair Dealing and U.S. Fair Use » (2008), 53 *McGill L.J.* 309, et *Century 21 Canada Limited Partnership c. Rogers Communications Inc.*, 2011 BCSC 1196, 338 D.L.R. (4th) 32, par. 234.

[27] Dans *CCH*, en prescrivant une interprétation généreuse des fins auxquelles il peut y avoir utilisation équitable, dont la « recherche », la Cour applique un critère relativement peu strict au premier volet, de sorte que le grand branle-bas analytique n’intervient qu’au second volet, celui de la

be restricted to the creation of new works would conflate the allowable purpose with the fairness analysis and unduly raise the bar for entering that analysis. Moreover, its restricted definitional scope of "research" contradicts not only the Court's admonition in *CCH* that "[i]n order to maintain the proper balance between the rights of a copyright owner and users' interests, [the fair dealing exception] must not be interpreted restrictively" (para. 48), but also its direction that the term "research" be given a "large and liberal interpretation" so that in maintaining that balance, users' rights are not unduly constrained (paras. 48 and 51).

[28] SOCAN's proposed definition of "research" as requiring "systematic investigation" and "new conclusions" is also at odds with its second submission about "research", namely, that "research" be analysed from the perspective of the purpose of the online service providers, and not that of the users. But its own proposed definition shows that it sees research as a user-focused undertaking, since the investigation and creation of new conclusions are clearly done *by* a user, not a provider. The provider's purpose in making the works available is therefore not the relevant perspective at the first stage of the fair dealing analysis.

[29] This is consistent with the Court's approach in *CCH*, where it described fair dealing as a "user's right" (para. 48). In *CCH*, the Great Library was the provider, offering a photocopying service to lawyers requesting copies of legal materials. The Court did not focus its inquiry on the library's perspective, but on that of the ultimate user, the lawyers, whose purpose was legal research (para. 64).

[30] Similarly, in considering whether previews are for the purpose of "research" under the first step

détermination du caractère équitable. Prétendre comme le fait la SOCAN que la « recherche » ne s'entend que de la création d'œuvres nouvelles équivaut à confondre la notion de fin permise et l'analyse du caractère équitable et à resserrer indûment le passage menant à celle-ci. En outre, sa conception étroite de la « recherche » ne tient compte ni de la mise en garde de la Cour dans *CCH*, à savoir que « [p]our maintenir un juste équilibre entre les droits des titulaires du droit d'auteur et les intérêts des utilisateurs, il ne faut pas [...] interpréter restrictivement [l'utilisation équitable] » (par. 48), ni de son exhortation à interpréter le mot « recherche [...] de manière large » afin d'éviter que, dans l'établissement de cet équilibre, les droits des utilisateurs soient indûment restreints (par. 48 et 51).

[28] En outre, lorsqu'elle définit la « recherche » comme comportant nécessairement une [TRADUCTION] « enquête systématique » et des « conclusions nouvelles », la SOCAN contredit sa deuxième prétention concernant l'interprétation du mot « recherche », à savoir que c'est la fin poursuivie par le fournisseur de services en ligne, et non par le consommateur, qui doit être considérée. En effet, la définition qu'elle propose montre qu'elle conçoit la recherche comme une entreprise de l'utilisateur, puisque, de toute évidence, c'est *lui*, et non le fournisseur, qui fait l'enquête et tire les conclusions nouvelles. À la première étape de l'analyse relative au caractère équitable de l'utilisation, le bon angle n'est donc pas celui du fournisseur et de la fin qu'il poursuit lorsqu'il met les œuvres à disposition.

[29] Cette conclusion est dans le droit fil de l'arrêt *CCH*, où la Cour voit dans l'utilisation équitable un « droit des utilisateurs » (par. 48). Dans cette affaire, le fournisseur — la Grande bibliothèque — offrait un service de photocopie aux avocats désireux d'obtenir copie de documents juridiques. La Cour analyse la situation du point de vue non pas de la bibliothèque mais de l'utilisateur, l'avocat, dont la fin poursuivie est la recherche juridique (par. 64).

[30] De même, afin de déterminer si, pour les besoins du premier volet du critère de l'arrêt

of *CCH*, the Board properly considered them from the perspective of the user or consumer's purpose. And from that perspective, consumers used the previews for the purpose of conducting research to identify which music to purchase, purchases which trigger dissemination of musical works and compensation for their creators, both of which are outcomes the *Act* seeks to encourage.

[31] The inquiry then moves to the second step, namely, determining whether the use of previews was "fair" in accordance with the *CCH* factors.

[32] Whether something is "fair" is a question of fact and depends on the facts of each case: *CCH*, at para. 52, citing *Hubbard v. Vosper*, [1972] 1 All E.R. 1023 (C.A.), at p. 1027. Based on all the factors, the Board concluded, properly in my view, that previews amounted to fair dealing.

[33] The first factor identified in *CCH* is the purpose of the dealing, where an objective assessment is made of the "real purpose or motive" behind using the copyrighted work (para. 54).

[34] SOCAN argued that the purpose of the previews in this case was purely commercial. This is an approach that looks at the purpose of the previews from the perspective not of the consumer, but of the service providers. I agree instead with the Board and the Federal Court of Appeal that the predominant perspective in this case is that of the ultimate users of the previews, and *their* purpose in using previews was to help them research and identify musical works for online purchase. While the service providers sell musical downloads, the purpose of providing *previews* is primarily to facilitate the research purposes of the consumers.

[35] The Board also noted that there were reasonable safeguards in place to ensure that the users' dealing in previews was in fact being used for this purpose: the previews were streamed, short, and often

CCH, la fin qui sous-tend l'écoute préalable est la « recherche », la Commission tient compte avec raison du point de vue de l'utilisateur ou de la fin que poursuit le consommateur. Sous cet angle, l'écoute préalable permet au consommateur d'effectuer une recherche pour choisir les pièces dont il fera l'achat, ce qui entraîne la diffusion des œuvres musicales et la rétribution de leurs créateurs, deux résultats voulus par le législateur.

[31] Vient ensuite le deuxième volet, où il faut déterminer si, au regard des éléments dégagés dans l'arrêt *CCH*, l'écoute préalable constitue une utilisation « équitable ».

[32] Le caractère « équitable » est une question de fait qui doit être tranchée à partir des circonstances de l'espèce : *CCH*, par. 52, citant *Hubbard c. Vosper*, [1972] 1 All E.R. 1023 (C.A.), p. 1027. À la lumière de tous les éléments à considérer, la Commission conclut, avec raison selon moi, que l'écoute préalable constitue une utilisation équitable.

[33] Le premier élément énoncé dans *CCH* est le but de l'utilisation. Il s'agit alors de déterminer objectivement le « but ou le motif réel » de l'utilisation de l'œuvre protégée (par. 54).

[34] La SOCAN fait valoir que, dans le cas qui nous occupe, l'écoute préalable a un but strictement commercial. Elle considère le but de l'écoute préalable du point de vue non pas du consommateur, mais du fournisseur de services. Je conviens plutôt avec la Commission et la Cour d'appel fédérale que l'angle d'analyse prédominant est en l'espèce celui de l'utilisateur et que la fin poursuivie par *ce dernier* lors de l'écoute préalable est la recherche d'œuvres musicales en vue d'en faire l'achat en ligne. Bien qu'il vende le téléchargement d'œuvres musicales, le fournisseur de services offre l'*écoute préalable* essentiellement pour faciliter la poursuite des fins de recherche du consommateur.

[35] La Commission relève également que des mesures garantissent raisonnablement que l'écoute préalable aura lieu à cette fin : les extraits sont courts, en continu et de qualité souvent

of lesser quality than the musical work itself. These safeguards prevented the previews from replacing the work while still fulfilling a research function.

[36] SOCAN also argued that even from the perspective of the consumers, the purpose of the previews was purely commercial, since their purpose was the potential purchase of musical works. Ultimately, however, the Board's approach is consistent with *CCH*'s observation that while research done for commercial reasons may be less fair than research done for non-commercial purposes (para. 54), the dealing may nonetheless be fair if there are "reasonable safeguards" in place to ensure that the works are actually being used for research (para. 66).

[37] The second factor discussed in *CCH* is the character of the dealing. The Court stated that a particular dealing might be unfair if multiple copies of works are being widely distributed (para. 55). But as the Court also pointed out, if a single copy of a work is used for a specific legitimate purpose, or if the copy no longer existed after it was used, this would favour a finding of fairness (para. 55).

[38] SOCAN's argument was based on the fact that consumers accessed, on average, 10 times the number of previews as full-length musical works. However, no copy existed after the preview was heard. The previews were streamed, not downloaded. Users did not get a permanent copy, and once the preview was heard, the file was automatically deleted from the user's computer. The fact that each file was automatically deleted meant that copies could not be duplicated or further disseminated by users.

[39] The third factor identified in *CCH* is the amount — or quantity — of the dealing. The Board characterized the "amount" of the dealing in terms of the length of each preview compared to the length of the work, concluding that streaming a preview of about 30 seconds was a modest dealing "when compared to purchasing the whole work

inférieure à celle de l'œuvre musicale. Ces caractéristiques empêchent la substitution des extraits aux œuvres, mais permettent néanmoins la recherche.

[36] La SOCAN fait par ailleurs valoir que même du point de vue du consommateur, la fin qu'il poursuit lors de l'écoute préalable est purement commerciale, car il s'agit de l'achat éventuel d'œuvres musicales. Or, tout compte fait, la démarche de la Commission respecte la remarque de la Cour dans *CCH*, à savoir que même si la recherche effectuée pour un motif commercial peut être moins équitable que celle effectuée à une fin non commerciale (par. 54), l'utilisation peut tout de même être équitable si on « garantit raisonnablement » que les œuvres sont effectivement utilisées aux fins de recherche (par. 66).

[37] Le deuxième élément à considérer selon l'arrêt *CCH* est la nature de l'utilisation. Pour la Cour, une utilisation peut être inéquitable lorsque de multiples copies d'une œuvre sont diffusées largement (par. 55). En outre, le fait qu'une seule copie sert à une fin légitime en particulier ou que la copie cesse d'exister après son usage milite en faveur du caractère équitable de l'utilisation (par. 55).

[38] La prétention de la SOCAN repose sur le constat que le consommateur accède en moyenne dix fois plus souvent à l'extrait d'une œuvre musicale qu'à sa version intégrale. Par contre, il ne reste pas de copie de l'extrait après l'écoute préalable. Les extraits sont transmis en continu; ils ne sont pas téléchargés. L'utilisateur n'obtient pas de copie permanente, et une fois l'écoute terminée, le fichier est supprimé automatiquement dans l'ordinateur, ce qui rend impossible toute reproduction ou nouvelle diffusion par l'utilisateur.

[39] Le troisième élément énoncé dans *CCH* correspond à l'ampleur de l'utilisation sur le plan quantitatif. La Commission, pour qui l'« ampleur » correspond à la durée de l'extrait par rapport à celle de l'œuvre en entier, conclut que l'écoute préalable d'un extrait d'une trentaine de secondes constitue une utilisation modeste « par rapport à l'achat de

[approximately four minutes] for repeated listening” (para. 113).

[40] SOCAN argued, however, that the proportion of the preview in relation to the length of the whole musical work was not the proper measure, and that the Board should have considered instead the *aggregate* number of previews that are streamed by consumers. Since the evidence showed that each user, on average, listened to 10 previews before purchasing a musical work for download, the overall amount of time spent listening to previews was so large that the dealing was unfair. SOCAN saw this factor as determinative in this case.

[41] There is no doubt that the aggregate quantity of music heard through previews is significant, but SOCAN’s argument conflicts with the Court’s statement in *CCH* that “amount” means the “quantity of the work taken” (para. 56). Since fair dealing is a “user’s” right, the “amount of the dealing” factor should be assessed based on the individual use, not the amount of the dealing in the aggregate. The appropriate measure under this factor is therefore, as the Board noted, the proportion of the excerpt used in relation to the whole work. That, it seems to me, is consistent with the Court’s approach in *CCH*, where it considered the Great Library’s dealings by looking at its practices as they related to specific works requested by individual patrons, not at the total number of patrons or pages requested. The “amount of the dealing” factor should therefore be assessed by looking at how each dealing occurs on an individual level, not on the aggregate use.

[42] Moreover, the quantification of the aggregate dissemination is already considered under the “character of the dealing” factor, which examines whether multiple copies of works are being widely distributed. Reconsidering the same “aggregate” quantity under the “amount” factor would deprive that factor of any utility in the analysis, and would erase consideration of the proportion of the excerpt to the entire work.

l’œuvre au complet [d’une durée approximative de quatre minutes] pour écoute répétée » (par. 113).

[40] La SOCAN écarte toutefois cette appréciation et fait valoir que la Commission doit plutôt tenir compte du nombre *global* d’extraits écoutés par les consommateurs au moyen de la transmission en continu. Comme la preuve révèle qu’un utilisateur écoute en moyenne 10 extraits d’une œuvre musicale avant de la télécharger contre paiement, le temps consacré globalement à l’écoute préalable est si considérable qu’il rend l’utilisation inéquitable. Il s’agit pour la SOCAN d’un élément déterminant en l’espèce.

[41] S’il ne fait aucun doute que l’écoute préalable donne globalement accès à une grande quantité de musique, l’argument de la SOCAN va toutefois à l’encontre de ce que dit la Cour dans *CCH*, à savoir que l’« ampleur » de l’utilisation s’entend de « l’ampleur [d’ordre quantitatif] de l’extrait tiré de l’œuvre » (par. 56). Puisque le droit d’utilisation équitable correspond à un droit des utilisateurs, il faut déterminer « l’ampleur » en fonction de l’utilisation individuelle, et non globale. C’est donc à l’aune du rapport entre l’extrait et l’œuvre entière, comme le préconise la Commission, qu’il faut déterminer l’ampleur de l’utilisation. Une telle conclusion me paraît conforme à la démarche de la Cour dans *CCH*, où elle qualifie l’utilisation des œuvres en se penchant sur les suites données par la Grande bibliothèque aux demandes individuelles formulées par des usagers relativement à des œuvres précises, et non sur le nombre total d’usagers ou le nombre total de pages demandées. Il faut donc apprécier l’élément de l’« ampleur de l’utilisation » au regard de chacune des utilisations individuelles plutôt que de l’ensemble des utilisations.

[42] Qui plus est, l’aspect quantitatif de la diffusion globale est déjà pris en compte en fonction de la « nature de l’utilisation », l’élément qui appelle à se demander si de multiples copies de l’œuvre sont largement distribuées. Revenir sur la même quantification « globale » en liaison avec l’élément de l’« ampleur » rend ce dernier inutile aux fins de l’analyse et soustrait à l’examen le rapport entre l’extrait et l’œuvre entière.

[43] Further, given the ease and magnitude with which digital works are disseminated over the Internet, focusing on the “aggregate” amount of the dealing in cases involving digital works could well lead to disproportionate findings of unfairness when compared with non-digital works. If, as SOCAN urges, large-scale organized dealings are inherently unfair, most of what online service providers do with musical works would be treated as copyright infringement. This, it seems to me, potentially undermines the goal of technological neutrality, which seeks to have the *Copyright Act* applied in a way that operates consistently, regardless of the form of media involved, or its technological sophistication: *Robertson v. Thomson Corp.*, [2006] 2 S.C.R. 363, at para. 49.

[44] The fourth factor identified in *CCH* involves considering any alternatives to the dealing. A dealing may be less fair if there is a non-copyrighted equivalent of the work that could have been used, or if the dealing was not reasonably necessary to achieve the ultimate purpose (para. 57).

[45] SOCAN argued that there were other methods available, like advertising, to help users identify potential music for purchase. Many of the service providers, for example, offered album artwork, textual descriptions, and user-generated album reviews. In addition, some service providers offered return policies in the event that users accidentally downloaded the wrong musical work.

[46] But allowing returns is an expensive, technologically complicated, and market-inhibiting alternative for helping consumers identify the right music. And none of the other suggested alternatives can demonstrate to a consumer what previews can, namely, what a musical work *sounds* like. The Board found that “[l]istening to a preview probably is the most practical, most economical and safest way for users to ensure that they purchase what they wish” (para. 114). As a result, it concluded that

[43] En outre, vu la facilité avec laquelle une œuvre numérisée peut être diffusée à grande échelle sur Internet, s’attacher à l’utilisation « globale » risque de mener à une conclusion d’utilisation inéquitable beaucoup plus souvent pour les œuvres qui sont numérisées que pour celles qui ne le sont pas. Si, comme le soutient la SOCAN, l’utilisation organisée et à grande échelle est intrinsèquement inéquitable, la quasi-totalité des activités des fournisseurs de musique en ligne qui sont liées aux œuvres musicales emporte la violation du droit d’auteur. Je crains que sa thèse n’aille à l’encontre de l’objectif de la neutralité technologique, c’est-à-dire l’application uniforme de la *Loi sur le droit d’auteur* peu importe le support ou son degré d’avancement technologique : *Robertson c. Thomson Corp.*, [2006] 2 R.C.S. 363, par. 49.

[44] En ce qui concerne le quatrième élément dans *CCH*, la Cour invite à examiner toute solution de rechange à l’utilisation. Le fait qu’un équivalent non protégé aurait pu servir ou que l’utilisation de l’œuvre n’était pas raisonnablement nécessaire eu égard à la fin visée pourrait militer contre le caractère équitable de l’utilisation (par. 57).

[45] La SOCAN prétend qu’il existe d’autres méthodes (telle la publicité) grâce auxquelles les consommateurs peuvent choisir la musique qu’ils veulent se procurer. Par exemple, le site de nombre de fournisseurs de services renferme une reproduction de la pochette, un texte descriptif et les critiques d’autres utilisateurs. Certains fournisseurs de services permettent également l’échange lorsqu’un utilisateur télécharge par mégarde une autre œuvre musicale que celle qu’il voulait.

[46] Or, lorsqu’il s’agit d’aider le consommateur à trouver des pièces musicales qui lui plaisent, l’échange constitue une solution coûteuse, complexe sur le plan technologique et défavorable à l’essor du secteur d’activité en cause. Qui plus est, aucune des solutions de rechange proposées ne permet au consommateur, comme seule le fait l’écoute préalable, d’entendre l’œuvre musicale, du moins en partie. La Commission estime que « [l]’écoute préalable d’un extrait est

short, low-quality streamed previews are reasonably necessary to help consumers research what to purchase. I agree.

vraisemblablement la façon la plus pratique, la plus économique et la plus sûre pour les [utilisateurs] de s'assurer d'obtenir ce qu'ils veulent » (par. 114). Elle arrive donc à la conclusion que l'écoute préalable de courts extraits de piètre qualité, transmis en continu, constitue un moyen raisonnablement nécessaire à la recherche par le consommateur de ce qu'il souhaite acquérir. Je suis du même avis.

[47] The fifth factor is the nature of the work, which examines whether the work is one which should be widely disseminated. SOCAN does not dispute the desirability of the sale and dissemination of musical works, but argues that since these works are easily purchased and disseminated without the use of previews, previews are of no additional benefit to promoting further dissemination. But the fact that a musical work is widely available does not necessarily correlate to whether it is widely disseminated. Unless a potential consumer can locate and identify a work he or she wants to buy, the work will not be disseminated.

[47] La nature de l'œuvre — le cinquième élément — appelle à se demander si l'œuvre est de celles qui devraient être largement diffusées. La SOCAN ne nie pas que la vente et la diffusion des œuvres musicales sont souhaitables, mais selon elle, puisque ces œuvres peuvent facilement être acquises et diffusées sans l'écoute préalable, celle-ci ne confère pas d'avantage supplémentaire pour l'optimisation de la diffusion. Or, un grand accès à une œuvre musicale ne coïncide pas nécessairement avec sa diffusion à grande échelle. Il n'y aura diffusion d'une œuvre que si un acquéreur éventuel peut la trouver et décider de l'acheter.

[48] This observation is linked to the final factor: the effect of the dealing on the work and whether the dealing adversely affects or competes with the work. Because of their short duration and degraded quality, it can hardly be said that previews are in competition with downloads of the work itself. And since the effect of previews is to *increase* the sale and therefore the dissemination of copyrighted musical works thereby generating remuneration to their creators, it cannot be said that they have a negative impact on the work.

[48] L'observation qui précède est liée au dernier élément : l'effet de l'utilisation sur l'œuvre et, notamment, le risque que l'utilisation nuise à l'œuvre ou y fasse concurrence. Étant donné la courte durée des extraits et leur piètre qualité, on peut difficilement leur reprocher de faire concurrence au téléchargement de l'œuvre complète. Et comme l'écoute préalable a pour effet d'*augmenter* les ventes d'œuvres musicales protégées par le droit d'auteur — et donc leur diffusion —, ce qui entraîne la rémunération de leurs créateurs, on ne saurait lui attribuer d'incidence négative sur les œuvres.

[49] All of this confirms the Board's conclusion that previews satisfy the requirements of fair dealing and that the online service providers do not infringe copyright. In so concluding, the Board properly balanced the purposes of the *Act* by encouraging the creation and dissemination of works while at the same time ensuring that creators are fairly rewarded. Its approach was consistent with *CCH*, with the interpretative principles it set out, and with its test for fair dealing under s. 29

[49] Toutes ces considérations confirment la conclusion de la Commission selon laquelle l'écoute préalable remplit les conditions de l'utilisation équitable et les fournisseurs de services en ligne ne violent pas le droit d'auteur. Pour arriver à cette conclusion, la Commission établit un juste équilibre entre les objets de la *Loi* en encourageant la création et la diffusion des œuvres, d'une part, et en veillant à la juste rétribution des créateurs, d'autre part. Elle respecte les paramètres établis

of the *Copyright Act*. The conclusion, as a result, should not be disturbed.

par la Cour dans *CCH*, les principes d'interprétation qui y sont énoncés et le critère qui y est formulé pour déterminer qu'une utilisation peut être assimilée ou non à l'utilisation équitable visée à l'art. 29 de la *Loi sur le droit d'auteur*. Par conséquent, il n'y a pas lieu de modifier sa conclusion.

[50] I would dismiss the appeal with costs.

[50] Je suis d'avis de rejeter l'appel avec dépens.

Appeal dismissed with costs.

Pourvoi rejeté avec dépens.

Solicitors for the appellant the Society of Composers, Authors and Music Publishers of Canada: Gowling Lafleur Henderson, Ottawa.

Procureurs de l'appelante la Société canadienne des auteurs, compositeurs et éditeurs de musique : Gowling Lafleur Henderson, Ottawa.

Solicitors for the appellant the Canadian Recording Industry Association: Osler, Hoskin & Harcourt, Ottawa.

Procureurs de l'appelante l'Association de l'industrie canadienne de l'enregistrement : Osler, Hoskin & Harcourt, Ottawa.

Solicitors for the appellant CMRRA-SODRAC Inc.: Cassels Brock & Blackwell, Toronto.

Procureurs de l'appelante CMRRA-SODRAC Inc. : Cassels Brock & Blackwell, Toronto.

Solicitors for the respondents Bell Canada, Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P. and TELUS Communications Inc.: Fasken Martineau DuMoulin, Ottawa.

Procureurs des intimées Bell Canada, Rogers Communications Inc., Rogers Wireless Partnership, Shaw Cablesystems G.P. et Société TELUS Communications : Fasken Martineau DuMoulin, Ottawa.

Solicitors for the respondent Apple Canada Inc.: Goodmans, Toronto.

Procureurs de l'intimée Apple Canada Inc. : Goodmans, Toronto.

Solicitor for the intervener the Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic: University of Ottawa, Ottawa.

Procureur de l'intervenante la Clinique d'intérêt public et de politique d'internet du Canada Samuelson-Glushko : Université d'Ottawa, Ottawa.

Solicitors for the intervener the Canadian Association of University Teachers: Torys, Toronto.

Procureurs de l'intervenante l'Association canadienne des professeures et des professeurs d'université : Torys, Toronto.

Solicitors for the interveners the Federation of Law Societies of Canada and the Canadian Legal Information Institute: Dimock Stratton, Toronto.

Procureurs des intervenants la Fédération des ordres professionnels de juristes du Canada et l'Institut canadien d'information juridique : Dimock Stratton, Toronto.

Solicitors for the intervener the Computer & Communications Industry Association: Heenan Blaikie, Toronto.

Procureurs de l'intervenante Computer & Communications Industry Association : Heenan Blaikie, Toronto.

TAB 2

Copyright Trolling, An Empirical Study

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ABSTRACT

This detailed empirical and doctrinal study of copyright trolling presents new data showing the astonishing rate of growth of multi-defendant John Doe litigation in United States district courts over the past decade. It also presents new evidence of the association between this form of litigation and allegations of infringement concerning pornographic films. Multi-defendant John Doe lawsuits have become the most common form of copyright litigation in several U.S. districts, and in districts such as the Northern District of Illinois, copyright litigation involving pornography accounts for more than half of new cases filed.

This Article highlights a fundamental oversight in the extant literature on copyright trolls. Paralleling discussions in patent law, scholars addressing the troll issue in copyright have applied status-based definitions to determine who is, and is not, a troll. This Article argues that the definition should be conduct-based. Multi-defendant John Doe litigation should be counted as part of copyright trolling whenever these suits are motivated by a desire to turn litigation into an independent revenue stream. Such litigation, when initiated with the aim of turning a profit in the courthouse as opposed to seeking compensation or deterring illegal activity, reflects a kind of systematic opportunism that fits squarely within the concept of litigation trolling. This Article shows that existing status-based definitions of copyright trolls are inapt because they do not account for what is now the most widely practiced form of trolling.

In addition to these empirical and theoretical contributions, this Article explores the features of copyright doctrine that have facilitated the recent explosion in trolling litigation in the form of litigation against John Does. In particular, it shows how statutory damages and permissive joinder make multi-defendant John Doe litigation possible and why allegations of infringement concerning pornographic films are particularly well-suited to this model.

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INTRODUCTION

Patent trolls are in the news¹ and they have been high on the agenda of intellectual property policy makers and academics for over a decade now.² In 2012, those targeted by patent aggregators and patent holding companies accounted for 56% of all patent defendants;³ depending on one's definition of a patent troll, the incidence of patent troll litigation may or may not be increasing;⁴ patent trolls have been condemned by the

¹ See e.g., Edgar Walters, "Tech Companies Fight Back Against Patent Lawsuits" N.Y. TIMES January 24, 2014. (<http://www.nytimes.com/2014/01/24/us/tech-companies-fight-back-against-patent-lawsuits.html>)

² See e.g., FTC, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, (2003), available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>; FTC, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* (2011), available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf>. See generally, Mark A. Lemley & A. Douglas Melamed, *Missing the Forest for the Trolls*, 113 Colum. L. Rev. 2117 (2013).

³ Christopher A. Cotropia, Jay P. Kesan & David L. Schwartz, Unpacking Patent Assertion Entities (PAEs) (working paper), see Figure 3.

⁴ Colleen Chien reports that patent trolls 29% filed in 2010 of patent lawsuits and 62% in 2012. Colleen Chien, *Patent Trolls by the Numbers* (available at <http://www.patentlyo.com/patent/2013/03/chien-patent-trolls.html>). However, new research using more transparent data finds that, based on the total number of patent litigants, there is almost no difference between 2010 and 2012. Christopher A. Cotropia, Jay P. Kesan & David L. Schwartz, Unpacking Patent Assertion Entities (PAEs) (working paper).

President;⁵ and targeted by new legislation.⁶ While patent trolls hog the limelight, a particular type of copyright troll has been taking over the dockets of several United States District Courts, and yet copyright trolls have received comparatively little attention in policy and academic circles. District court judges have certainly commented on how the nature of copyright litigation is changing,⁷ but until now there has been no systematic in-depth analysis of the data.⁸ This Article remedies this deficiency.

This empirical study of copyright trolling presents new data revealing the astonishing growth of a particular kind of copyright trolling — the Multi-Defendant John Doe (“MDJD”) lawsuit alleging copyright violation through the file sharing software known as BitTorrent. Generally, these suits take the form of “Copyright Owner v. John Does 1 – N” where N is a large number.⁹ MDJD suits are not just a form of copyright trolling; they are the dominant form. In 2013, these MDJD suits were the majority of copyright cases filed in 19 out of 92 federal districts.¹⁰

⁵ President Obama recently stated “They don’t actually produce anything themselves...They are essentially trying to leverage and hijack somebody else’s idea and see if they can extort some money out of them.” <http://www.whitehouse.gov/blog/2013/06/04/taking-patent-trolls-protect-american-innovation>. See also, Executive Office of the President, *Patent Assertion and U.S. Innovation* (June 2013).

⁶ Leahy-Smith America Invents Act (AIA), Pub. L. No. 112-29, 125 Stat. 284 (2011) (codified in scattered sections of 35 U.S.C.). The AIA included a revision to the joinder rules for patent litigation, which required lawsuits filed against multiple unrelated parties to be filed separately, a provision squarely aimed at patent trolls. The Saving High-Tech Innovators from Egregious Legal Disputes Act of 2013 (SHIELD Act), H.R. 845, 113th Cong. (2013) is a sweeping bill aimed at “stopping patent troll lawsuits” likely to consider by the Senate in early 2014.

⁷ See, e.g., *In re BitTorrent Adult Film Copyright Infringement Cases*, 2012 U.S. Dist. LEXIS 61447,1 (E.D.N.Y. May 1, 2012) (“These actions are part of a nationwide blizzard of civil actions brought by purveyors of pornographic films alleging copyright infringement by individuals utilizing a computer protocol known as BitTorrent.”)

⁸ The Copyright Office has never addressed the issue of copyright trolls, nor does Copyright Office’s recent report on Copyright Small Claims even mention them. COPYRIGHT OFFICE, *Copyright Small Claims, A Report to the Register of Copyrights*, September 2013 (available at <http://www.copyright.gov/docs/smallclaims/usco-smallcopyrightclaims.pdf>.) For non-empirical discussions of the MDJD phenomenon see e.g., James DeBriyn, *Shedding Light on Copyright Trolls: An Analysis of Mass Copyright Litigation in the Age of Statutory Damages*, 19 UCLA ENT. L. REV. 79 (2012); Sean B. Karunaratne, *The Case Against Combating BitTorrent Piracy Through Mass John Doe Copyright Infringement Lawsuits*, 111 MICH. L. REV. 283 (2012); Patience Ren, *The Fate of BitTorrent John Does: A Civil Procedure Analysis of Copyright Litigation*, 64 HASTINGS L.J. 1343 (2013); Gregory S. Mortenson, *BitTorrent Copyright Trolling: A Pragmatic Proposal for a Systemic Problem*, 43 SETON HALL L. REV. 1105 (2013).

⁹ Not all plaintiffs in such suits are trolls in the sense that this term is invoked in the patent literature – i.e., they are not all non-practicing entities – but the conclusion of this Article is that these massive multi-party john doe (“MDJD”) suits are by and large instances of trolling.

¹⁰ Alabama (SD), Colorado, Delaware, District Of Columbia, Florida (MD), Georgia (ND), Georgia (SD), Illinois (CD), Illinois (ND), Indiana (ND), Maryland, Michigan (ED), Ohio (SD), Pennsylvania (ED), Tennessee (ED), Tennessee (WD), Washington (WD), Wisconsin (ED) and Wisconsin (WD). In 2013, pornography MDJD suits accounted for over of suits filed in 11 federal districts: Alabama (SD), District Of Columbia, Illinois (CD), Illinois (ND), Indiana (ND), Maryland, Michigan (ED) Pennsylvania (ED), Tennessee (ED), Tennessee (WD) and Wisconsin (ED).

Defining exactly what makes an individual or an organization a troll is inevitably controversial.¹¹ The essence of trolling is that the plaintiff is more focused on the business of litigation than on selling a product or service or licensing their IP to third parties to sell a product or a service. The paradigmatic troll plays a numbers game in which it targets hundreds or thousands of defendants, seeking quick settlements priced just low enough that it is easier for the defendant to pay the troll directly rather than pay his lawyers to defend the claim. This is a familiar pattern in patent law where trolls thrive by opportunistically taking advantage of the uncertain scope of patent claims, the poor quality of patent examination, the high cost of litigation and the asymmetry of stakes faced by the patent assertion entities and the businesses they target.¹²

As this Article demonstrates, a similar numbers game is increasingly dominating copyright litigation. Copyright suits against John Does comprised over 43% copyright claims filed in 2013. The economic viability of MDJD litigation depends on suing as many defendants as possible in a single action to keep costs low and leveraging the threat of statutory damages in order to maximize the flow of settlement dollars. As discussed in more detail in Part I, it is fair to regard these suits as a form of copyright trolling.

Copyright trolls may draw inspiration from their patent counterparts, but they are a product of two unique features of copyright law: the first is the incentives created by statutory damages; the second is the permissive approach to joinder taken by many district courts in file-sharing cases.¹³ The theory behind these MDJD lawsuits is that individuals who share the same movies and other copyrighted works via BitTorrent are can be joined together in a single copyright lawsuit.¹⁴ Litigating a case all the way to trial against thousands of individuals in the same suit would be ridiculous and unwieldy,¹⁵ but these suits are not filed with an actual hearing in mind. MDJD lawsuits are filed to take advantage of court ordered discovery to break the veil of anonymity that separates IP addresses from the account information of actual human beings.¹⁶ They are means to compel Internet Service Providers such as Comcast and AT&T to give plaintiff copyright owners names and addresses to match the IP addresses that they already have.

¹¹ See generally, Lemley & Melamed, *Missing The Forest For The Trolls*, 113 COLUM. L. REV. 2117 (2013).

¹² *Id.*

¹³ See *infra* Part II-A on statutory damages and Part II-B on joinder.

¹⁴ See *infra* Part II-B.

¹⁵ Just imagine how long a scheduling conference would take.

¹⁶ Parties generally may not initiate discovery prior to satisfying the meet and confer requirement of FED. R. CIV. P. 26(f), however this is not possible where the defendant is identified by their IP address and has not been served. Thus plaintiffs in MDJD suits must apply for earlier discovery under FED. R. CIV. P. 26(d). See, *Digital Sin, Inc. v. Does 1-176*, 279 F.R.D. 239, 241 (S.D.N.Y. 2012). Note also that without a Court-ordered subpoena, many of the ISPs, who qualify as "cable operators" for purposes of 47 U.S.C. § 522(5), are effectively prohibited by 47 U.S.C. § 551(c) from disclosing the identities of the putative defendants to Plaintiff. *Id.*

After obtaining the names and addresses of account holders suspected of participating in a BitTorrent swarm, the plaintiff can set to work negotiating settlements.¹⁷ An account holder accused of infringement is almost invariably threatened with statutory damages and the prospect of paying the plaintiff's attorneys fees if he is unable to establish his innocence.¹⁸ Reports indicate that settlements are usually in the range of \$2000 to \$4000 – this is a lot to pay for any movie, but a small fraction of the potential statutory damages for willful copyright infringement, which can be as high as \$150,000 per work infringed.¹⁹ The \$4000 figure is also evidently “a sum calculated to be just below the cost of a bare-bones defense.”²⁰ This does not prove that the plaintiffs are simply pursuing nuisance value settlements, but it is consistent with that theory.

In addition to relying on statutory damages and permissive joinder, Part II of this Article shows that the majority of MDJD suits also feature an additional ingredient—pornography.²¹ Not all MDJD lawsuits relate to pornography, but the association with pornography is far from coincidental. The MDJD model works especially well for pornography because the potential embarrassment of being accused (accurately or not) of downloading such material is a great motivation to settle.

This Article proceeds as follows: Part I locates MDJD suits within the broader context of the IP troll debate. It explains why attempts to define copyright trolls in terms status – i.e., in terms of the plaintiff's relationship to the underlying IP – are ultimately flawed and suggests a conduct focused approach based on identifying systematic opportunism. Part I explains why MDJD lawsuits should typically be regarded as copyright trolling and it explores the basic economics of MDJD litigation. Part I then presents empirical data documenting the astonishing rise of MDJD lawsuits over the past decade. Part II explores the role of statutory damages and permissive joinder in MDJD lawsuits in terms of the economic model developed in Part I. Part II also explains why the economics of in this type of litigation is so well-suited to allegations of infringement concerning pornography and presents new data on the prevalence of pornography related MDJD lawsuits. Part III presents concrete proposals for copyright reform designed to make copyright trolling less attractive. This Part explains how, even in the absence of legislative reform, district court judges can exercise their discretion over joinder and early discovery to ensure that statutory damages are not excessive and to insist on a variety of procedural safeguards.

¹⁷ *Malibu Media, LLC v. Doc*, 2013 U.S. Dist. LEXIS 139068, 2 (N.D. Ill. Sept. 27, 2013) (“Once the identities become known to the plaintiff, the John Does are served with process. The defendants then either settle with the plaintiffs, default, or contest the suit.”)

¹⁸ See e.g., Settlement Letter from Steele & Hansmeier, PLLC (May 16, 2011), available at <http://www.scribd.com/doc/80437326/Steele-Hansmeier-Settlement-Demand-Letter-First-Time-Videos>. (Explaining statutory damages and offering to settle \$2,900).

¹⁹ 17 U.S.C. § 504(c) (statutory damages).

²⁰ *Ingenuity 13 LLC v. John Doe*, 2:12-CV-8333-ODW JCX, 2013 WL 1898633 (C.D. Cal. May 6, 2013).

²¹ See *infra*, Part II-C.

PART I THE RISE OF THE COPYRIGHT TROLL

This Part documents the rise of the copyright troll as an empirical phenomenon. As part of the foundation for the empirical exercise, Part I-A locates MDJD litigation within the broader context of the IP troll debate. It explains why the existing focus of the literature on examples such as Righthaven overlooks the most important manifestations of trolling. Part I-B explains why MDJD lawsuits typically should be regarded as trolling. Part I-C explores the basic economics of MDJD litigation. Part I-D then presents the empirical data on the rise of MDJD lawsuits over the past decade.

A. Copyright Trolls and Copyright Trolling

(1) Righthaven

From 2010 to 2011, a Nevada-based company called Righthaven LLC set about a business model that can be summarized in three simple steps: (1) recruit content owners, principally newspapers; (2) identify plausible cases of copyright infringement, such as the reposting newspaper articles on blogs; (3) acquire a partial assignment of copyright tailored precisely to the infringement identified in step two.²² Note that steps one and two can easily be reversed. This model generated significant profits from a string of quick settlements.

The Righthaven model began to look vulnerable when a number of defendants were able to establish that their conduct fell within the scope of the fair use doctrine.²³ However, the real problem for Righthaven turned out to be that its standing to sue was built on a "nothing more than a fabrication".²⁴ The limited exclusive rights that Righthaven had received from the original content *appeared* to satisfy the requirement for copyright standing – only the legal or beneficial owner of an exclusive right under copyright law is entitled, or has standing, to sue for infringement.²⁵ However, those assignments were subject to a secret "Strategic Alliance Agreement" that meant that all Righthaven possessed was a mere right to sue.²⁶ An agreement transferring the right to

²² Shyamkrishna Balganesh, *The Uneasy Case Against Copyright Trolls*, 86 S. CAL. L. REV. 723 (2013).

²³ E.g., *Righthaven, LLC v. Hoehn*, 792 F. Supp. 2d 1138, 1147-51 (D. Nev. 2011); *Righthaven LLC v. Realty One Grp., Inc.*, No. 2:10-cv-1036-LRH-PAL, 2010 U.S. Dist. LEXIS 111576, at 4-6 (D. Nev. Oct. 18, 2010); *Righthaven LLC v. Klerks*, No. 2:10-cv-00741-GMN-LRL, 2010 U.S. Dist. LEXIS 105307, at 6-10 (D. Nev. Sept. 17, 2010) (finding a sufficient meritorious fair use defense to set aside a default).

²⁴ *Righthaven LLC v. Democratic Underground, LLC*, 791 F. Supp. 2d 968, 973 (D. Nev. 2011).

²⁵ See *Silvers v. Sony Pictures Entm't Inc.*, 402 F.3d 881, 884 (9th Cir. 2005) (en banc).

²⁶ *Righthaven LLC v. Democratic Underground, LLC*, 791 F. Supp. 2d 968, 972 (D. Nev. 2011) (Section 7.2 of the Strategic Alliance Agreement between Righthaven and Stephens Media provided that "Despite any such Copyright Assignment, Stephens Media shall retain (and is hereby granted by Righthaven) an exclusive license to Exploit the Stephens Media Assigned Copyrights for any lawful purpose whatsoever and Righthaven shall have no right or license to Exploit or participate in the receipt of royalties from the Exploitation of the Stephens Media Assigned Copyrights other than the right to proceeds in association with a Recovery.")

sue without any of the copyright owner's exclusive rights is ineffectual. Following these revelations, Righthaven's suits were dismissed and the firm quickly succumbed to the weight of legal fees and went into insolvency.²⁷

In his thought provoking article on the copyright troll phenomenon, Professor Shyamkrishna Balganesh offered the following definition: "A copyright troll refers to an entity whose business revolves around the systematic legal enforcement of copyrights in which it has acquired a limited ownership interest."²⁸ Balganesh argued that the real problem with copyright trolls is not this delegation of enforcement of itself, but rather the fact that such delegation disrupts the "enforcement equilibrium" that is integral to the functioning of copyright as an institution.²⁹

This seems to fit the Righthaven story, but perhaps a little too well. Righthaven targeted defendants who were largely non-commercial and whose alleged infringements were usually inconsequential to the copyright owner's bottom line. Righthaven disrupted the previous enforcement equilibrium by attempting to monetize borderline cases of infringement that without its intervention would have either been ignored or tolerated. Balganesh's definition of copyright trolls, which focuses on the delegation of enforcement to a separate entity, has echoes of patent law's concerns with non-practicing entities and patent aggregators.

Righthaven is a compelling example, but it is just one example.³⁰ As the data in this Article shows, a status-based conception of copyright trolling does not fit particularly well with is the predominant form of copyright trolling witnessed in federal courts over the last few years. MDJD lawsuits typically do not involve any assignment of rights. By focusing on delegation through assignment, a status-based definition overlooks most of the reality of copyright trolling in practice. Arguably, there is still a form of delegation in MDJD cases in that the handling of these suits is given over to specialized law firms who in many instances recruit their clients. If these specialized law firms are working on contingency, their incentives will be virtually the same as an entity that acquired rights solely for the purpose of litigation. The willingness of entrepreneurial law firms to pursue allegations of infringement on contingency makes any status-based definition of trolls and trolling in copyright obsolete.³¹ Patent litigation is driven by different economic

²⁷ Ian Polonsky, *You Can't Go Home Again: The Righthaven Cases And Copyright Trolling On The Internet*, 36 Colum. J.L. & Arts 71 (2012).

²⁸ Balganesh *supra* note 150 at 732.

²⁹ *Id.*

³⁰ Another example unrelated to MDJD litigation is arguably the textile printer L.A. Printex. Charles Colman, "California federal jury finds for copyright plaintiff L.A. Printex in Aeropostale fabric pattern case: blurgh" LAW OF FASHION February 1, 2013 ("L.A. Printex has developed something of a bad reputation in the fashion world, having brought more copyright infringement cases than one can count against a plethora of fashion designers and retailers, most of whom find it cheaper to settle than to fight the frequently questionable lawsuits.") (Available at <http://lawoffashion.com/blog/story/02/01/2013/173>).

³¹ Statements about the relationship between the plaintiffs and their legal counsel in MDJD cases are necessarily merely generalizations.

fundamentals, but the evidence from copyright at least raises a serious question as to whether the current status-based ideas of who is and is not a patent troll are really viable.

Another potentially misleading aspect of troll discussions focusing on Righthaven is the idea that the problem with copyright trolls is that they disrupt existing conventions of tolerated use.³² MDJD file-sharing lawsuits typically do not relate to boundary issues fair use or tolerated use—unauthorized file sharing using BitTorrent and similar software tools is not a legal gray area.³³ It is strenuously objected to by the mainstream of creative industries and is clearly not fair use or *de minimus*. We would do better to define trolling than trolls.

(2) *Beyond Righthaven*

Copyright trolling cannot be defined by characteristics such as whether the plaintiff is the original owner of the copyright, or whether the plaintiff has attempted to license the work in the marketplace. Descriptively, these indicia may provide some useful shortcuts, but they would exclude the majority of troll litigation in copyright. In seeking to define what makes a litigant a troll, we would do better to focus on conduct rather than status. We should, in short, seek to identify instances of trolling rather than looking for trolls *per se*.

If anything unifies the patent law and copyright law experience of trolls, it is the sense that a troll is a systematic opportunist.³⁴ The reason why agreeing on an exact definition of trolls is so difficult is that there are so many different manifestations of opportunism in IP litigation. In the patent context, some plaintiffs are labeled as trolls because they exploit flaws in the administration of the patent system, such as the uncertain scope of patent claims and the poor quality of patent examination. Others are labeled as trolls because they take advantage of asymmetric stakes and the high cost of litigation to extract settlements or licensing fees based on dubious claims. The claims may be dubious in the sense that, if fully litigated, the defendant would be very likely to win. The troll's case may also be dubious in the sense that even if their patents are technically valid and infringed under our current legal standards, this simply reflects the failure of those standards to adequately promote investment in innovation and invention.

In addition to opportunism relating to litigation strategy, the decision to base a business model on litigation can be seen as a form of opportunism in itself. Patent trolls acquire and assert patents based on the their litigation potential rather than the value of the underlying technology. On this view, the essence of trolling is that the plaintiff is

³² Tim Wu, *Tolerated Use*, 31 COLUM. J.L. & ARTS 617, 619 (2008)

³³ See *Metro-Goldwyn-Mayer Studios Inc. v. Gorkster, Ltd.*, 545 U.S. 913 (2005); *A & M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir.2001); *BMG Music v. Gonzalez*, 430 F.3d 888, 890 (7th Cir.2005).

³⁴ On opportunism in general, see Kenneth Ayotte, Ezra Friedman and Henry E. Smith, *A Safety Valve Model of Equity as Anti-Opportunism* (Available at SSRN: <http://ssrn.com/abstract=2245098>) (explaining the development of equity as part of the law's response to the problem of opportunism).

more focused on the business of litigation than on selling a product or service or licensing their IP to third parties to sell a product or a service.

Copyright trolls are best defined in terms of a cluster of attributes rather than any single definitive feature. A troll deserving of the name either asserts rights it does not have, makes poorly substantiated claims or tenuous of infringement, or seeks disproportionate remedies. Trolls do at least one of these things on a systematic basis.³⁵ The opportunism of copyright trolls is primarily directed towards statutory damages. As the Righthaven example shows, statutory damages can make the pursuit of otherwise inconsequential infringements extremely profitable, more profitable than licensing those uses in advance could ever have been. As the MDJD cases show, statutory damages stack the deck in favor of the plaintiff such that the underlying liability of the defendant is effectively irrelevant to the settlement calculation.

B. When does Multi-Defendant John Doe Lawsuit Amount Copyright Trolling?

Not all BitTorrent lawsuits are exercises in copyright trolling. In fact the Recording Industry Association of America ("RIAA") pioneered the MDJD model as part of its broader campaign against illegal file sharing over a decade ago. Modern copyright trolling follows the RIAA's template, but with a different motivation.

In 2003 the RIAA began a widely publicized campaign of lawsuits against individual file sharers, characterized by Justice Breyer as "a teaching tool"³⁶ and by the RIAA itself as "the enforcement phase of its education program."³⁷ The RIAA wound down this program in 2008, by which time over 35,000 individuals had been targeted with letters of demand.³⁸ The RIAA and its members are not copyright trolls because the industry's end-user litigation strategy was aimed at sending a message not creating an independent revenue stream.

The RIAA sought to channel potential infringers back into the legitimate market: in contrast, more recent MDJD suits appear to prefer the revenues available in the courthouse to those of the market place. In 2010, a Hollywood production company, Voltage Pictures, filed a series of lawsuits against thousands of John Does for

³⁵ Of course, Rule 11 provides for sanctions against plaintiffs and attorneys who make frivolous or unsupportable claims,³⁵ but establishing a Rule 11 violation is notoriously difficult. See e.g., *Giddings v. Vision House Production, Inc.*, 584 F.Supp.2d 1222 (D.Ariz 2008). (Plaintiff's legal theory ultimately proved to be incorrect but was not "so objectively baseless to qualify as completely frivolous and subject to sanctions under Rule 11"). In *Raw Films, Ltd. v. Does 1-32* allegations of harassment lead to a show cause order relating to sanctions, but sanctions were not ultimately imposed. *Raw Films, Ltd. v. Does 1-32*, 2011 WL 6182025, at *2 (E.D.Va. Oct. 5, 2011).

³⁶ 545 U.S. at 963 (Breyer, J., concurring).

³⁷ Press Release, RIAA, *Recording Industry Begins Suing P2P File Sharers Who Illegally Offer Copyrighted Music Online* (Sept. 8, 2003), available at <http://www.riaa.org/newsitem.php?id=85183A9C-28F4-19CE-BDE6-F48E206CE8A1>.

³⁸ See, e.g., Sarah McBride & Ethan Smith, *Music Industry to Abandon Mass Suits*, WALL ST. J., Dec. 19, 2008, at B1.

downloading its film *The Hurt Locker* over BitTorrent.³⁹ These suits were filed as *Voltage Pictures, LLC v. Does 1 – 5000*,⁴⁰ and eventually totaled 24,500 defendants.⁴¹ The *Voltage Pictures* cases have now been voluntarily dismissed, but only after thousands of user records were subpoenaed from ISPs and thousands of demand letters were sent to account subscribers. Statements by the plaintiff's lawyers confirm that this litigation campaign was not aimed at deterrence or compensation; their intention was to "creat[e] a revenue stream and monetize[e] the equivalent of an alternative distribution channel."⁴²

C. The Economics of Multi-Defendant John Doe Lawsuits

To understand the copyright trolling phenomenon, it is useful to begin with its economic fundamentals. This section explores those fundamentals by developing a simple model the costs and benefits of MDJD litigation from the point of view of the plaintiff.

The plaintiff (or realistically, the plaintiff's lawyer) in any MDJD lawsuit faces certain fixed costs (C_f) such as detecting potential infringement, drafting the initial complaint, drafting a motion for discovery, and appearing in court to argue in favor of discovery. Detecting potential infringement requires an investment in technology and/or technological expertise.⁴³ The remaining fixed costs largely consist of attorney time. These costs do not change significantly whether there is one defendant or 5000 in a single case. The plaintiff also faces variable costs (C_v) primarily related to the time and effort it takes to persuade Internet Service Providers to divulge subscriber information and to persuade the subscribers thus identified to settle. Where N is the number of defendants, the plaintiff's costs can be represented as follows:

$$\text{Costs} = C_f + C_v * N$$

The plaintiff's recovery depends primarily on the average settlement obtained (P or payoff), the percentage of defendants who can be persuaded to settle (Y or yield) and the number of defendants (N).⁴⁴ Thus,

$$\text{Recovery} = P * Y * N$$

³⁹ See e.g., *Voltage Pictures, LLC v. Does*, Docket No. 1:10-cv-00873 (D.D.C. May 24, 2010).

⁴⁰ *Id.*

⁴¹ First Amended Complaint for Copyright Infringement at 1, *Voltage Pictures, LLC v. Vasquez*, No. 1:10-cv-00873 (D.D.C. Apr. 22, 2011), ECF No. 143-1.

⁴² Eriq Gardner, *New Litigation Campaign Quietly Targets Tens of Thousands of Movie Downloaders*, HOLLYWOOD REP. (Dec. 21, 2010), <http://www.hollywoodreporter.com/blogs/thr-esq/litigation-campaign-quietly-targets-tens-63769>.

⁴³ It may also be the case that by contracting with outside technology firms, the cost of detecting infringement can be transformed into a variable cost.

⁴⁴ The obvious simplification here is that there is just one settlement price. In theory, a plaintiff with perfect information could extract high settlements from easy targets and low settlements from more intransigent ones.

The economic viability of copyright trolling in the form of MDJD litigation depends on suing as many defendants as possible in a single action to keep costs low and leveraging the threat of statutory damages (and sometimes other threats) in order to maximize the product of payoff and yield ($P*Y$). Thus,

$$\begin{aligned} \text{Profit} &= (P*Y*N) - (C_f + C_v*N) \\ &= N(PY - C_v) - C_f \end{aligned}$$

This model does not assume that all defendants are in fact liable for copyright infringement, but it does assume that the plaintiff's case is strong enough to make a certain proportion of defendants want to settle.⁴⁵ Even so, a plaintiff cannot expect to be able to locate the person responsible for every IP address named in the lawsuit, nor can it expect every accused infringer to be solvent or to settle without a costly fight. However, the plaintiff can expect that most individuals who it does locate and who do have the capacity to pay will eventually capitulate and agree to settle for a few thousand dollars.⁴⁶ Most defendants in this situation will settle because even with fee shifting, settling for a few thousand dollars will cost less on a risk-adjusted basis than establishing their innocence in court. As discussed in more detail in Part II-A, the prospect of statutory damages ensures that despite the possibility of fee shifting, a very small chance of being found liable is enough to make settlement the defendant's best option.⁴⁷ Making money from this type of litigation depends on dispersing one's fixed costs over a large group of defendants and persuading a reasonable number of defendants to settle reasonably quickly. Part II of this Article will return to this basic economic model and use it to explain the significance of joinder, statutory damages and pornography in MDJD lawsuits.

D. The Rise of Multi-Defendant John Doe Lawsuits

Just how widespread is the practice of generating revenue through MDJD lawsuits?⁴⁸ To answer this question, I created a database that includes all copyright cases filed in the all federal district courts circuits between January 1, 2001 and December 31, 2013.⁴⁹ "John Doe" lawsuits were identified by hand, based initially on the appearance of the words "John Doe" and "Doe" in the case title (in plural and singular form).⁵⁰ Figure 1 displays the resulting data broken down by circuit and into three-year time periods based

⁴⁵ Parts II-A (statutory damages) and II-C (pornography) further explain why defendants will be motivated to settle, even if the plaintiff's case is far from watertight.

⁴⁶ *Ingenuity 13 LLC v. John Doe*, 2:12-CV-8333-ODW JCX, 2013 WL 1898633 (C.D. Cal. May 6, 2013) (finding that settlement offers were generally about \$4,000)

⁴⁷ See *infra* Part II-A

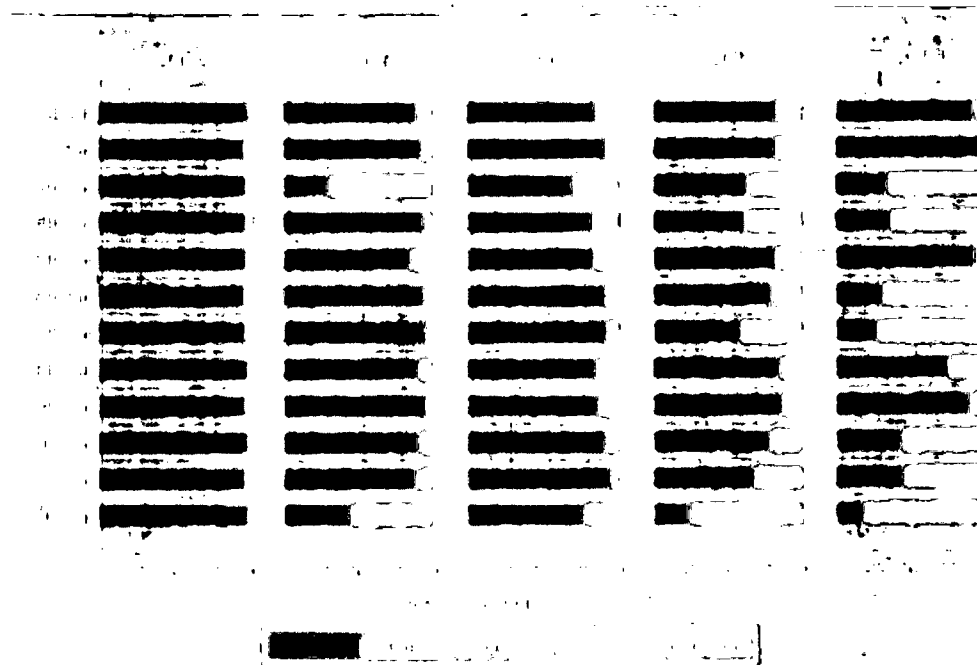
⁴⁸ Many Judges have noted the increasing prevalence of these suits. See e.g. *In re BitTorrent Adult Film Copyright Infringement Cases*, Nos. 11-3995(DRH)(GRB), 12-1147(JS)(GRB), 12-1150(LDW)(GRB), 12-1154(ADS)(GRB), 2012 WL 1570765, at *1 (E.D.N.Y. May 1, 2012) ("These actions are part of a nationwide blizzard of civil actions brought by purveyors of pornographic films alleging copyright infringement by individuals utilizing a computer protocol known as BitTorrent.")

⁴⁹ Note: this dataset will be expanded to all circuits in a future draft.

⁵⁰ Cases with titles such as "___ v. *Unknown Parties*" were also included.

on the year of filing, beginning with the year 2001. The figure shows the prevalence of John Doe actions as a percentage of all copyright filings in each circuit. The figure highlights the recent growth of MDJD lawsuits and their uneven geographic concentration. It is particularly noteworthy that MDJD suits made up the majority of copyright filings in Third, Fourth, Sixth, Seventh, Tenth, Eleventh and DC Circuits in 2013.

Figure 1: Percentage of John Doe Law Suits by Circuit, 2001-03, 2004-06, 2007-09, 2010-12, 2013



MDJD suits were almost non-existent 10 years ago; as of 2013 they were the majority of filings in 19 out of 92 federal districts.⁵¹ MDJD suits accounted for just over 16% of filings between 2001 and 2013,⁵² but they account for over 42% of filings in 2013. The sudden rise of the MDJD copyright lawsuit is apparent from Figure 2, below which focuses in on the years 2010, 2011, 2012 and 2013. This Figure shows the prevalence of John Doe lawsuits as a percentage of all copyright lawsuits over the past four years, by state, excluding states with no John Doe copyright suits.

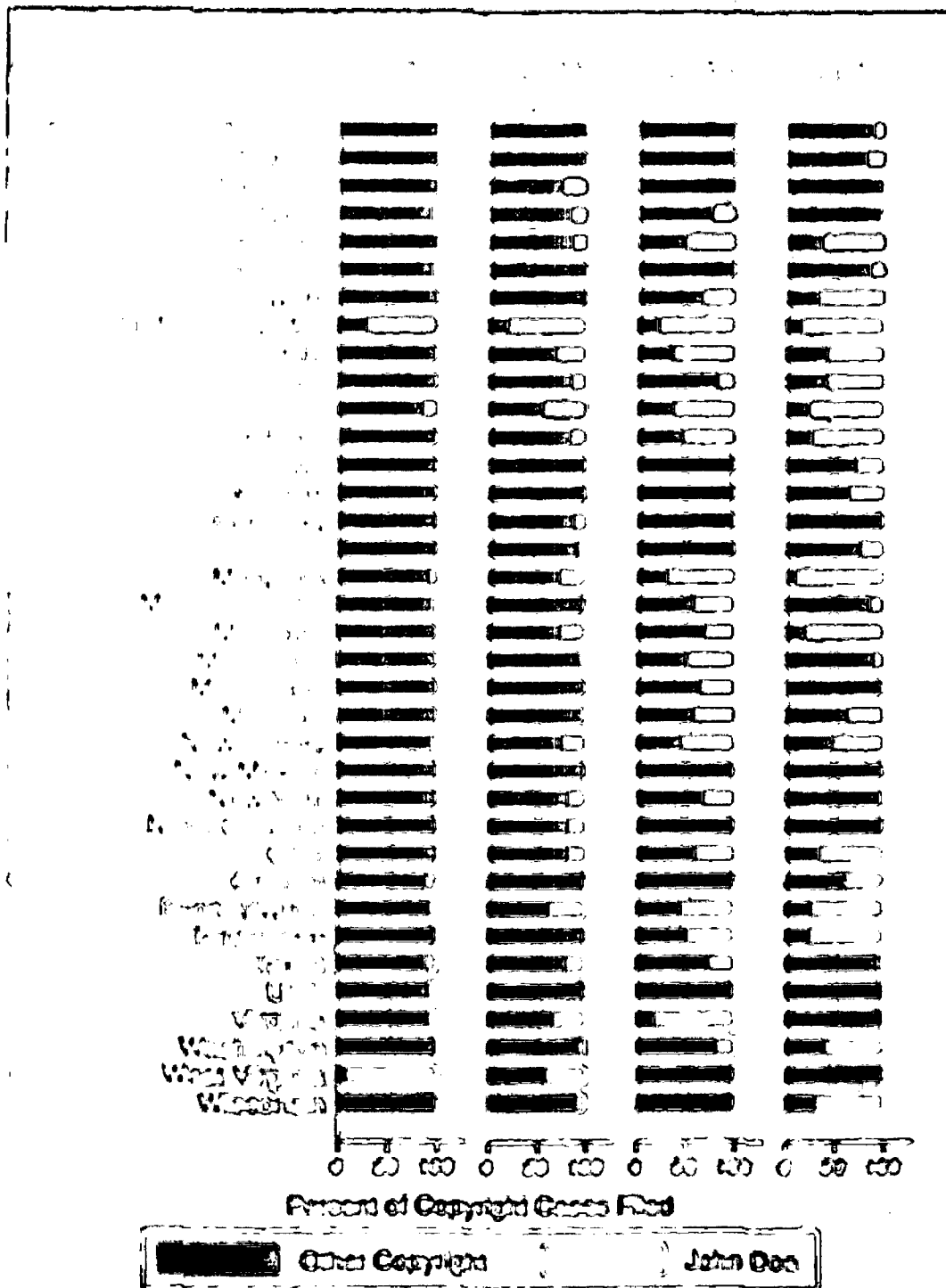
As the figure above shows, in 2010 there was substantial MDJD litigation in the District of Columbia and West Virginia and small pockets in California, Connecticut, Illinois, Oregon, Maryland, Massachusetts, New Jersey, Oregon, Texas, Utah and Virginia. By 2012, MDJD suits were the majority of all copyright cases filed in Colorado,

⁵¹ See *supra* note 10.

⁵² 1993 out of 19,142, to be exact.

Delaware, Florida, Georgia, Illinois, Indiana, Maryland, Michigan, Ohio, Pennsylvania, Tennessee, Washington, Wisconsin and the District Of Columbia. Interestingly, 2013 saw a sharp decline in the proportion of these suits in California and New York.

Figure 2: John Doe lawsuits as a percentage of all copyright lawsuits 2010–2013, by State



* Some cases with no John Doe filer excluded

This original data shows, for the first time, the astonishing rate of growth of this particular form of copyright trolling. MDJD lawsuits are not just the predominant form of copyright trolling; they are the dominant form of copyright litigation in several districts. It is to be hoped that now that the extent of this kind of copyright trolling is apparent has been made apparent, it will receive some attention from policy makers.⁵³

II. STATUTORY DAMAGES, JOINDER & PORNOGRAPHY

This Part focuses on the role of statutory damages, permissive joinder and pornography in enabling MDJD litigation to thrive. Part II-A explores the role of statutory damages in MDJD lawsuits in terms of the economic model developed previously. Part II-B takes the same approach with joinder. Part II-C explains why MDJD litigation is so well-suited to allegations of infringement concerning pornography and presents new data on the prevalence of pornography in this context. Understanding these components is vital to developing sound reform proposals, the subject of Part III.

A. Statutory Damages

U.S. copyright law allows the plaintiff to elect, at any time before final judgment, to receive statutory damages in lieu of actual damages or an account of the defendant's profit.⁵⁴ Statutory damages were originally designed to overcome the difficulties injured plaintiffs faced in proving the true extent of their damage or of the defendant's profits.⁵⁵ However, statutory damages now appear to be largely divorced from that original purpose. Critically, statutory damages effectively guarantee a minimum rate of recovery regardless of proof of damages or profits.⁵⁶

Statutory damages provide compensation for real world harms that may be difficult to establish in the courtroom. The problem with statutory damages, as a matter of both design and application, is that the amounts awarded bear no relationship to the harm of infringement, the need for deterrence, or generally accepted norms of proportionality

⁵³ It is not apparent that the issues of copyright trolls or MDJD litigation are on the Copyright Office's reform agenda. See Statement of Maria A. Pallante Register of Copyrights United States Copyright Office before the Subcommittee on Courts, Intellectual Property and the Internet, Committee on the Judiciary, "The Register's Call for Updates to U.S. Copyright Law," (March 20 2013) (available at <http://www.copyright.gov/regstat/2013/regstat03202013.html>) (not mentioning copyright trolls, MDJD litigation). See also Maria A. Pallante, *The Next Great Copyright Act*, COLUMBIA JOURNAL OF LAW & THE ARTS (2013) (noting in passing that "arguments abound on the subject of statutory damages, suggesting that they are either too high, too low, too easy, or too hard to pursue.")

⁵⁴ 17 U.S.C. § 504(c)

⁵⁵ See, Pamela Samuelson & Tara Wheatland, *Statutory Damages in Copyright Law: A Remedy in Need of Reform*, 51 WM. & MARY L. REV. 439 (2009) at 448 (Summarizing the legislative history of the 1909 Copyright Act.)

⁵⁶ The only prerequisite for statutory damages is copyright registration. 17 U.S.C. § 412 (requiring registration within three months of publication to qualify for awards of statutory damages and attorneys fees).

in the administration of penalties.⁵⁷ A recent review of statutory damages by Samuelson and Wheatland cites several arbitrary, inconsistent, incoherent and excessive awards of statutory damages in copyright cases.⁵⁸ In one of the most striking examples, *Capitol Records v. Thomas-Rasset*, a jury awarded statutory damages of more than \$1.92 million against a defendant who had illegally downloaded about \$54 worth of music on a peer-to-peer file-sharing network.⁵⁹ That is a ratio of more than 35,000 to 1.

There are many problems with the current statutory damages framework, but as they relate to the issue of copyright trolling, the basic defect of statutory damages is that the range is too broad and too high. The Copyright Act of 1976 allows for statutory damages anywhere in a range between \$750 and \$150,000⁶⁰ – that is the difference between an average priced 55 inch flat screen television⁶¹ and the median sale price of a single-family home in the Mid-West of the United States.⁶² Technically, the upper \$30,000 to \$150,000 of this range is confined to cases of “willful infringement”⁶³ and should be reserved for truly exceptional cases,⁶⁴ however “courts have interpreted willfulness so broadly that those who merely should have known their conduct was infringing are often treated as willful infringers.”⁶⁵

Recall the formula in Part I: $Profit = N(PY - C_v) - C_f$. Statutory damages play a significant role in the profitability of copyright trolling. Without statutory damages, defendants might cling to the idea that their infringements are so trivial that the plaintiff will not bother to pursue them. They might decide to wait it out and take the risk. An individual copyright owner who establishes a single instance of illegal downloading could hope to recover some approximation of the retail price of their product as the measure of damage they have suffered or as disgorgement of the defendant’s profits from

⁵⁷ For a comprehensive review of the history and current application of statutory damages in copyright, see Samuelson & Wheatland, *supra* note 50.

⁵⁸ *Id.* at 442-43.

⁵⁹ *Capitol Records v. Thomas-Rasset* 579 F. Supp. 2d 1210, 1213, 1227 (D. Minn. 2008) (“Thomas allegedly infringed on the copyrights of 24 songs-the equivalent of approximately three CDs, costing less than \$ 54.”).

⁶⁰ 17 USC 504(c).

⁶¹ E.g., at the time of writing, the LG Electronics 55LN5400 55-Inch 1080p 120Hz LED-LCD HDTV with Smart Share was available on Amazon.com for \$749.

⁶² NATIONAL ASSOCIATION OF REALTORS, *Existing-Home Sales Data* (available at <http://www.realtor.org/topics/existing-home-sales/data>) (reporting the median sales price of existing single-family homes in the Mid-West of the U.S. as \$143,700 in 2012, \$150,800 in November 2013 and 155,700 for all of 2013).

⁶³ 17 USC 504(c).

⁶⁴ See S. REP. No. 94-473, at 144-45 (1975) (enhanced damages should be available in “exceptional cases”); H.R. REP. No. 94-1476, at 162 (1975) (same). See also Samuelson & Wheatland, *supra* note 55 (summarizing the legislative history).

⁶⁵ Samuelson & Wheatland, *supra* note 50 at 441. See also Nimmer §14.04[B][3][a] (citing cases). Note that even those defendants with plausible fair use defenses may be characterized as “egregious and willful” infringers, see e.g. *Rogers v. Koons*, 960 F.2d 301, 313 (2d Cir. 1992).

infringement. For the typical music single, album, television show, or movie, this would be in the range from \$1 to \$20.

The credible threat of damages as high as \$150,000 makes any real risk of being found liable for copyright infringement intolerable for anyone who is not completely insolvent or staggeringly wealthy. Without statutory damages, the plaintiff in a typical BitTorrent suit might recover only nominal damages, thus reducing their expected settlement payoff (P) to almost zero. For a single infringement, statutory damages increase the potential settlement range from \$0 – \$20 to \$0 – \$150,000. But the point is not just that statutory damages increase the average payoff (P); the threat of statutory damages also reduces the Plaintiff's variable cost (C_v) by acting as a tool of persuasion that brings reluctant defendants to heel more quickly. In addition, because the possibility of a \$150,000 verdict makes the plaintiff's claims that it will pursue the case to the bitter end more credible, it should substantially increase settlement yield (Y) compared to a world without statutory damages.⁶⁶ For the plaintiff in MDJD cases, statutory damages are the pot of gold at the end of the litigation rainbow. Statutory damages make the stakes of copyright litigation fundamentally uneven. While both plaintiff and defendant could lose and be forced to pay the other side's attorneys fees, only the plaintiff is entitled to statutory damages. The possibility of fee shifting for successful defendants should make troll-like behavior less rewarding in copyright, but the risk of statutory damages more than negates the benefits of fee shifting.

B. Joinder

Joinder also plays an important role in the economics of MDJD litigation. From the perspective of the plaintiff, rules relating to joinder are favorable if they permit the joining of defendants with a low level of relatedness. A low threshold of relatedness allows the plaintiff to spread its fixed costs across a large number of defendants.⁶⁷ Joinder rules are also plaintiff friendly to the extent that they allow a case to proceed to discovery in a MDJD case without a substantial investment in proving the alleged underlying infringements.⁶⁸

The economic logic of MDJD lawsuits relies on permissive joinder of large numbers of tenuously related defendants in thinly substantiated actions that are never intended to go to trial. There is no doubt that BitTorrent is widely used for copyright infringement, nonetheless many of the MDJD cases are questionable for two reasons. First, they typically rely on a snapshot of Internet activity that does not show that a complete file was downloaded.⁶⁹ All that the snapshot shows is that a download was initiated. Second, the MDJD cases rely on the inference that the account owner behind an

⁶⁶ The extent to which more explicitly punitive damages could substitute for statutory damages will be discussed in Part III, *infra*.

⁶⁷ Thus C_v/N is reduced.

⁶⁸ Thus C_v itself is reduced.

⁶⁹ See e.g., *Ingenuity 13 LLC v. John Doe*, 2:12-CV-8333-ODW JCX, 2013 WL 1898633 (C.D. Cal. May 6, 2013).

IP address was in fact responsible for any use made of that account.⁷⁰ The possibility of hacking, open Wi-Fi networks, Internet accounts accessed by multiple users, and mistakes by ISPs open the door to numerous highly fact specific “it wasn’t me” defenses.⁷¹ These two weaknesses can be overcome, but only by investing individual time and effort into each case, something that is anathema to the copyright trolling model.

The appropriateness of joinder in MDJD litigation has divided federal district courts across the country. The Federal Rules of Civil Procedure allow defendants to be joined in a single action subject to two requirements set forth in Fed. R. Civ. P. 20(a)(2). First, the right to relief must be asserted against the defendants “jointly, severally, or in the alternative with respect to or arising out of the same transaction, occurrence, or series of transactions or occurrences.”⁷² Second, there must be common questions of fact or law.⁷³ It is important to note that joinder is not merely allowed under the Federal Rules of Civil Procedure, it is strongly encouraged. The Supreme Court held in *United Mine Workers v. Gibbs* that “the impulse is toward the broadest possible scope of action consistent with fairness to the parties.”⁷⁴ The current split in the district courts on whether joinder is proper in MDJD suits centers around the courts’ understanding of the BitTorrent file sharing technology — specifically whether the phrase “same transaction or occurrence or series of transactions or occurrences” properly applies to the participants in a BitTorrent swarm.

BitTorrent works by segmenting a large file into thousands of smaller pieces that can be downloaded in any order and reassembled by the end user. This initial process is called “seeding”. Once a file is seeded, it can be downloaded by multiple individuals simultaneously. The group of individuals downloading the seeded file is known as the ‘swarm’. One advantage of BitTorrent over other file sharing programs is that there is no need to maintain a connection between the seeder and the downloader for the duration of the download. Any participant in the swarm can download any fragment from any other participant who already has it. Swarm members are typically downloading and uploading file-fragments from other computers in the swarm at the same time.⁷⁵ The probability that any two swarm members chosen at random have directly interacted is less than one, and it could be quite low in a large swarm. The basic theory in MDJD litigation is that all

⁷⁰ *Id.*

⁷¹ *Third Degree Films, Inc. v. Doe*, 2013 U.S. Dist. LEXIS 44131, 26, n7 (E.D. Mich. Mar. 18, 2013) (noting that “plaintiff’s counsel represented that approximately 95% of defendants in cases such as this raise some form of the ‘it wasn’t me’ defense.”); *In re BitTorrent Adult Film Copyright Infringement Cases*, 2012 U.S. Dist. LEXIS 61447, 2012 WL 1570765 at *12 (noting the “panoply of individual defenses including age, religious convictions, and technological savvy; misidentification of ISP accounts; the kinds of WiFi equipment and security software utilized; and the location of defendant’s router.”).

⁷² Fed. R. Civ. P. 20(a)(2)(A).

⁷³ Fed. R. Civ. P. 20(a)(2)(B).

⁷⁴ *United Mine Workers v. Gibbs*, 383 U.S. 715, 724 (1966). (joinder of claims, parties and remedies is strongly encouraged.)

⁷⁵ *Malibu Media, LLC v. Doe*, 2013 U.S. Dist. LEXIS 139068, 4-5 (N.D. Ill. Sept. 27, 2013)

swarm participants are involved in a "series of transactions or occurrences" that are sufficiently related to allow joinder.⁷⁶

Courts are divided as to whether, by itself, participation in a BitTorrent swarm meets the "same transaction or occurrence or series of transactions or occurrences" standard under Fed. R. Civ. P. 20(a)(2)(A).⁷⁷ Many courts have rejected joinder based on swarm participation alone.⁷⁸ For example, the district court in *Dragon Quest Prods., LLC v. Does*, held that "the initial seeder, other seeders, the various peers, and the Defendants may have participated in this swarm months apart from each other. While ... the initial seeder, the other seeders, the peers, and the Defendants, may be connected by the same initial seed file, the Court finds that this connection alone is not sufficient to establish joinder."⁷⁹ Some plaintiffs have overcome this obstacle by pleading specifically that the Doe defendants had in fact shared the same pieces of the file with each other.⁸⁰ Others have focused on groups of John Does who acted within a short time frame.⁸¹

⁷⁶ See *infra*.

⁷⁷ See *infra* note 65 for examples of cases concluding joinder is impermissible or inappropriate. See *infra* note 69 for examples of cases allowing joinder.

⁷⁸ See e.g. *SBO Pictures, Inc. v. Does* 1-57, No. 12-22, 2012 U.S. Dist. LEXIS 56578, 2012 WL 1415523, *2 (D. Md. Apr. 20, 2012) (denying joinder); *MCGIP, LLC v. Does* 1-149, No. 11-2331, 2011 U.S. Dist. LEXIS 108109, 2011 WL 4352110, *3 (N.D. Cal. Sep. 16, 2011) (misjoinder where plaintiff "has failed to show that any of the 149 Doe defendants actually exchanged any piece of the seed file with one another"); *Hard Drive Productions, Inc. v. Does* 1-188, 809 F.Supp.2d 1150, 1164 (N.D. Cal. 2011) (finding no concerted action where plaintiff conceded that defendants "may not have been physically present in the swarm on the exact same day and time"); *Boy Racer, Inc. v. Does* 1-60, No. 11-1738, 2011 U.S. Dist. LEXIS 92994, 2011 WL 3652521, at *4 (N.D. Cal. Aug. 19, 2011) (severing defendants where plaintiff did not plead facts showing that any particular defendant illegally shared plaintiff's work with any other particular defendant); *Patrick Collins, Inc. v. Does* 1-23, No. 11-CV-15231, 2012 U.S. Dist. LEXIS 40536, 2012 WL 1019034, at *4 (E.D. Mich. Mar. 26, 2012) (severing the Doe defendants because the infringement of the film via BitTorrent did not constitute a "series of transactions or occurrences"); *SBO Pictures, Inc. v. Does*, 2011 U.S. Dist. LEXIS 137361, 2011 WL 6002620, at *3 (same).

⁷⁹ *Dragon Quest Prods., LLC v. Does*, 2013 U.S. Dist. LEXIS 83683, 24-25 (D.N.J. June 13, 2013).

⁸⁰ See e.g., *Malibu Media, LLC v. Doe*, 2013 U.S. Dist. LEXIS 139068, 6 (N.D. Ill. Sept. 27, 2013) (Plaintiff alleges ... John Does accessed the same piece of the copyrighted work, and each piece is identified by a unique value known as a "Hash Identifier" or "Hash Number."); *Digital Sin, Inc. v. Does* 1-176, 279 F.R.D. 239, 243 (S.D.N.Y. 2012) (Declining to sever where "Plaintiff claims to have carefully selected only a small group of New York-based defendants who traded the exact same file, identifiable by a hash value, as part of the same swarm within a six-week period.") *Sunlust Pictures, LLC v. Does* 1-75, 2012 U.S. Dist. LEXIS 121368, 2012 WL 3717768, at *3. (Noting that "Sunlust alleges in its complaint that the defendants participated in the swarm simultaneously and that it observed the defendants transferring data from the Video between themselves.")

⁸¹ *TCYK, LLC v. Does*, 2013 U.S. Dist. LEXIS 177765 (finding temporal proximity of 62 doe defendants alleged to have acted within a four day period sufficient). See also, *Pac. Century Int'l v. Does* 1-31, No. 11 C 9064, 2012 U.S. Dist. LEXIS 82796, 2012 WL 2129003, at *2 (N.D. Ill. June 12, 2012) (allegations that the defendants participated in the same swarm at varying times spanning just over one month supported permissive joinder).

However, a number of courts have taken a broader view and held that this specific level of interaction is not necessary and that merely participating in the same swarm is sufficient for joinder under Fed. Rule 20.⁸² As the district court in *Malibu Media, LLC v. John Does 1-6* explained, Rule 20 does not require that defendants acted “in concert” or with any “temporal distance or temporal overlap”; all that Rule 20 requires is “a logical relationship between the separate causes of action.”⁸³ In *Patrick Collins, Inc. v. Does 1-21*, the court found that logical relationship was satisfied because “each Doe Defendant downloaded the same Torrent file that was created by the same initial seeder, intending to: 1) utilize other users’ computers to download pieces of the same [Copyrighted Works], and 2) allow his . . . own computer to be used in the infringement by other peers and Defendants in the same swarm.”⁸⁴

On this view, joining the participants in a BitTorrent swarm in a single action is proper because the swarm is more than a collection of individuals acting the same way, it is in essence a cooperative endeavor, whether the participants are personally known to each other or not.⁸⁵ This interpretation is bolstered by the fact that Rule 20(a) refers to a “series of transactions or occurrences” and not just the “same transaction.”⁸⁶ Astute plaintiffs have also bolstered the case for joinder by adding claims for inducement and contributory liability.⁸⁷

Even if the individual participants in a BitTorrent swarm are sufficiently related to permit joinder under the Federal Rules, which appears likely, district courts still have the power to disallow joinder for discretionary reasons.⁸⁸ Here too, the courts are divided.⁸⁹ In

⁸² See e.g., *Pacific Century Int'l v. Does 1-31*, No. 11-9064, 2012 U.S. Dist. LEXIS 82796, 2012 WL 2129003, *2 (N.D. Ill. June 12, 2012) (allowing joinder where “the anonymous defendants participated in the same ‘swarm’”); *Digital Sin, Inc. v. Does 1-176*, 279 F.R.D. 239, 244 (S.D.N.Y. 2012); *Bicycle Peddler, LLC v. Does 1-12*, No. 13 C 2372, 2013 U.S. Dist. LEXIS 95184, 2013 WL 3455849, at *3-4 (N.D. Ill. July 9, 2013); *Patrick Collins, Inc. v. Does 1-39*, No. 12-CV-00096-AW, 2012 U.S. Dist. LEXIS 57187, 2012 WL 1432224, at *3 (D. Md. Apr. 24, 2012); *First Time Videos, LLC v. Does 1-76*, 276 F.R.D. 254, 257 (N.D. Ill. 2011).

⁸³ See e.g., *Malibu Media, LLC v. John Does 1-6*, 291 F.R.D. 191,204 (N.D. Ill. 2013); *TCYK, LLC v. Does 1-62*, 13 C 3842, 2013 WL 6671675 (N.D. Ill. Dec. 18, 2013).

⁸⁴ *Patrick Collins, Inc. v. Does 1-21*, 282 F.R.D. at 165 (E.D. Mich. 2012). See also *Malibu Media, LLC v. John Does 1-6*, 291 F.R.D. 191,204 (N.D. Ill. 2013)(same); *TCYK, LLC v. Does 1-62*, 13 C 3842, 2013 WL 6671675 (N.D. Ill. Dec. 18, 2013)(same).

⁸⁵ *Id.* (“Every member of a swarm joins that cooperative endeavor knowing that, in addition to downloading the file, they will also facilitate the distribution of that identical file to all other members of the swarm.”) See also *TCYK, LLC v. John Does 1-87*, 2013 U.S. Dist. LEXIS 95817, 2013 WL 3465186, at *4 (same).

⁸⁶ *Id.*

⁸⁷ See e.g., *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 158 (D. Mass. 2013).

⁸⁸ Fed. R. Civ. P. 21 provides that the court may add or drop a party on motion or on its own “on just terms”. The court may also sever any claim against a party. See e.g., *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 156-157 (D. Mass. 2013) (Finding that although “joinder of the defendants may be permissible under Fed. R. Civ. P. 20(a), the interests of justice and judicial economy would best be served if all of the defendants except Doe Number 1 were severed and dropped from the case pursuant to Fed. R. Civ. P. 21.”)

part, the division of opinion as to whether joinder is appropriate under the Federal Rules can be seen as a conflict between *formalism* and *realism*.

For the formalist judge, the complaint is the beginning of a process that ultimately leads to a hearing. If the joinder of 5000 very loosely related individuals would make it impossible to conduct a hearing based on the merits, joinder appears to be unsound.⁹⁰ The court in *Third Degree Films, Inc. v. Does 1-131* explained at length the practical problems that make joinder in MDJD suits inappropriate: differences in factual and legal defenses would generate completely unrelated motions; scheduling and conducting hearings and discovery disputes among a large number of parties would be almost impossible; *pro se* defendants without access to the e-filing system would be forced to serve paper copies of all filings on all other parties; all defendants, including those proceeding *pro se* would have an interest in attending all other parties' depositions and may do so as a matter of right; any eventual trial would require a hundred separate mini-trials with different witnesses and evidence, "eviscerating any 'efficiency' of joinder."⁹¹ Cumulatively, these obstacles would substantially delay the ultimate resolution of any particular defendant's case and thus from this perspective joinder appears unsound.⁹²

For the realist judge, the complaint is the beginning of a process that almost inevitably leads to settlement and thus joinder is an efficient way of aggregating claims at the early stage of litigation for which there is very likely no later stage. The minority of defendants who actively contest that liability can have their cases severed at a later point in time. In the meantime, allowing MDJD suits to proceed to the discovery stage is efficient to the extent that it reduces the plaintiff's costs.

The conflict between realism and formalism is not entirely determinative of the appropriateness of joinder in MDJD cases. A number of courts have also refused to allow MDJD cases to proceed *en masse* because of their association with "potentially abusive litigation tactics."⁹³ These courts accept that "a valid copyright holder is entitled to seek

⁸⁹ See, e.g., *Malibu Media 1-30*, 2012 U.S. Dist. LEXIS 175919, 2012 WL 6203697 (permitting joinder); *Malibu Media, LLC v. John Does 1-5*, 285 F.R.D. 273 (S.D.N.Y. 2012) (permitting joinder); *Malibu Media, LLC v. John Does 1-22*, No. 12-5091, 2013 U.S. Dist. LEXIS 56147, 2013 WL 1704291 (D.N.J. Apr. 19, 2013) (severing and dismissing all defendants other than John Doe #1); *Amselfilm Prods. GMBH & Co. KG v. Swarm 6a6dc*, No. 12-3865, 2012 U.S. Dist. Lexis 186476, (D.N.J. Oct. 10, 2012) (finding joinder to be inappropriate and severing the defendants); *Next Phase Distribution, Inc. v. John Does 1-27*, 284 F.R.D. 165 (S.D.N.Y. 2012) (not deciding whether joinder was proper, but severing the defendants based on practical considerations).

⁹⁰ See e.g. *Malibu Media, LLC v. John Does 1-39*, No. 12-6945, Doc. No. 23, 2013 U.S. Dist. LEXIS 44053 (D.N.J. Mar. 28, 2013) (The court noted that its "ability to efficiently manage the pretrial phase of this action with the present number of defendants could be compromised by permitting joinder, causing a strain on judicial resources.")

⁹¹ *Third Degree Films, Inc. v. Does 1-131*, 280 F.R.D. 493, 498-99 (D. Ariz. 2012) reconsideration denied, CV 12-0108-PHX-JAT, 2012 WL 2383560 (D. Ariz. June 25, 2012)

⁹² *Id.*

⁹³ *Third Degree Films v. Doe*, 286 F.R.D. 188, 189 (D. Mass. 2012) ("In recent months, this Court has grown increasingly troubled by 'copyright trolling,' specifically as it has evolved in the adult film industry. ... Against this backdrop of mass lawsuits and potentially abusive litigation tactics, courts

protection of its intellectual property in federal court” but they remain wary of suits filed “solely to facilitate demand letters and coerce settlement, rather than ultimately serve process and litigate the claims.”⁹⁴ This doubtful impression has been reinforced by the failure of plaintiffs to actually serve the individual defendants in many cases.⁹⁵ Courts have noted that much of the coercive force of the settlement offer derives from the pornography at issue, not the alleged copyright infringement.⁹⁶ The extraordinary leverage plaintiffs obtain in John Doe pornography cases is manifest by the number of Doe defendants who rush to settle before being identified in the public record.⁹⁷

Some courts have also taken issue with one of the main sources of efficiency in the MDJD model, the evasion of filing fees.⁹⁸ For example, the court in *In re BitTorrent Adult Film Copyright Infringement Cases* estimated that “plaintiffs have improperly avoided more than \$25,000 in filing fees by employing its swarm joinder theory. . . . Nationwide, these plaintiffs have availed themselves of the resources of the court system on a scale rarely seen. It seems improper that they should profit without paying statutorily required fees.”⁹⁹

nationwide have become skeptical of allowing the adult film companies unfettered access to the judicial processes of subpoenas and early discovery”). See also *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 156-157 (D. Mass. 2013); *Kick Ass Pictures, Inc. v. Does 1-25*, C.A. No. 12-10810-MLW, 2013 U.S. Dist. LEXIS 1386, 2013 WL 80162, at *1 (D. Mass. Jan. 4, 2013). See also *Pacific Century Int'l, Ltd. v. Does 1-101*, 2011 U.S. Dist. LEXIS 124518, 2011 WL 5117424, at *2.

⁹⁴ *Third Degree Films v. Does 1-47*, 286 F.R.D. 188, 190 (D. Mass. 2012) (footnotes omitted). See also *Hard Drive Prods., Inc. v. Does 1-90*, No. C 11-03825 HRL, 2012 U.S. Dist. LEXIS 45509, 2012 WL 1094653, at *3 & n.4 (N.D. Cal. Mar. 30, 2012). 2012 U.S. Dist. LEXIS 45509, [WL] at *7. (“Plaintiff seeks to enlist the aid of the court to obtain information through the litigation discovery process so that it can pursue a non-judicial remedy that focuses on extracting ‘settlement’ payments from persons who may or may not be infringers. This the court is not willing to do.”)

⁹⁵ See e.g. *Hard Drive Prods., Inc. v. Does 1-90*, No. C 11-03825 HRL, 2012 U.S. Dist. LEXIS 45509, 2012 WL 1094653, at *3 & n.4 (N.D. Cal. Mar. 30, 2012). (magistrate judge refused to grant expedited discovery to subpoena the ISP providers for the Doe defendants’ identities after noting that the adult film company plaintiff conceded that to its knowledge, neither it nor any other plaintiff had ever served a single Doe defendant after early discovery had been granted.)

⁹⁶ *Third Degree Films v. Does 1-47*, 286 F.R.D. at 197; *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 165-166 (D. Mass. 2013) (expressing concern that joinder is being used “to facilitate a low-cost, low-risk revenue model for the adult film companies.”) *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 157 (D. Mass. 2013) (“Although the record before this court reveals no evidence of improper tactics or bad faith by Patrick Collins in this action, the fact that four settlements have occurred before any of the defendants have been identified in the public record illustrates how these types of cases create a strong tool for leveraging early settlements.”)

⁹⁷ *Id.*

⁹⁸ *In re BitTorrent Adult Film Copyright Infringement Cases*, 2012 U.S. Dist. LEXIS 61447, 2012 WL 1570765, at *13. (estimating that “plaintiffs have improperly avoided more than \$25,000 in filing fees by employing its swarm joinder theory. . . . Nationwide, these plaintiffs have availed themselves of the resources of the court system on a scale rarely seen. It seems improper that they should profit without paying statutorily required fees.”)

⁹⁹ *In re BitTorrent Adult Film Copyright Infringement Cases*, 2012 U.S. Dist. LEXIS 61447, 2012 WL 1570765, at *13.

For a combination of all of these reasons a substantial number of courts have severed all but the first named defendant and required plaintiffs to re-file individually in a substantial number of cases.¹⁰⁰

C. The Copyright Trolling-Pornography Nexus

Conventional wisdom asserts that 15 percent of Internet traffic is comprised of cat videos¹⁰¹ and 30 percent is pornography.¹⁰² Cat videos do not feature prominently in MDJD lawsuits; pornography is another story.¹⁰³ To investigate the copyright trolling-pornography nexus, I individually reviewed at least one underlying complaint per John Doe plaintiff in the dataset and coded the plaintiff as either 'pornography' or 'not pornography' accordingly.¹⁰⁴

¹⁰⁰ Third Degree Films v. Does 1-47, 286 F.R.D. at 198. ("Although this court emphasizes that it has observed no bad faith behavior on the part of the plaintiff thus far, "the Court takes issue with the general structure of this case and like cases, and has determined that the most appropriate method to protect against any potential coercion is to sever the Doe defendants and require them to be sued individually.") See also Patrick Collins, Inc. v. Does 1-38, 941 F. Supp. 2d 153, 166 (D. Mass. 2013).

¹⁰¹ See e.g., <http://www.cbsnews.com/videos/cat-videos-take-over-internet-marketing-world/>

¹⁰² See "Porn Sites Get More Visitors Each Month Than Netflix, Amazon And Twitter Combined" THE HUFFINGTON POST, May 4, 2013, available at http://www.huffingtonpost.com/2013/05/03/internet-porn-stats_n_3187682.html.

¹⁰³ It is beyond the scope of this Article to address the question of the copyright status of pornographic works. Pornography is not generally illegal and even if it were, "the prevailing view is that even illegality is not a bar to Copyrightability," see Flava Works, Inc. v. Gunter, 689 F.3d 754, 755-56 (7th Cir. 2012). See also Mitchell Bros. Film Grp. v. Cinema Adult Theatre, 604 F.2d 852, 862-63 (5th Cir. 1979); Jartech, Inc. v. Clancy, 666 F.2d 403, 406 (9th Cir. 1982). But see Ann Bartow, *Copyright Law and Pornography*, 91 OR. L. REV. 1 (2012) (questioning whether copyright should protect pornography and particular sub-categories of pornography).

¹⁰⁴ I relied on descriptions of works as 'adult content', descriptions on IMDB and reasonable inferences from titles such "My Little Panties # 2". I did not watch any of the underlying titles.

Figure 3: Percentage of John Doe Law Suits by Circuit, 2001 to 2013

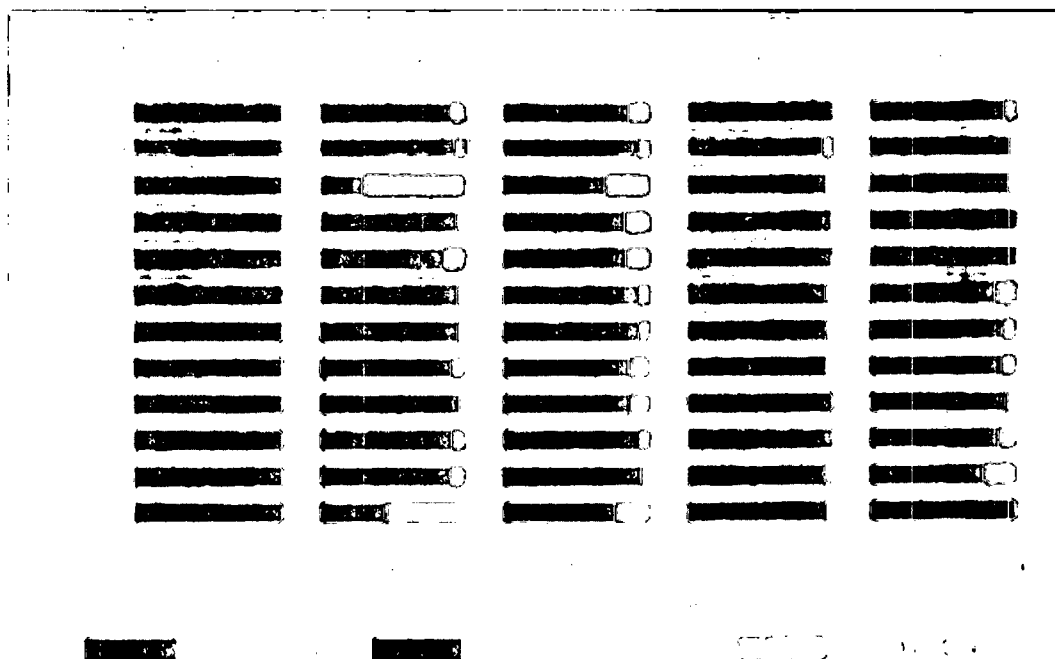


Figure 3 illustrates the relative frequency of John Doe litigation as a percentage of all copyright litigation broken down by circuit and into three-year time periods based on the year of filing, beginning with the year 2001. Figure 3 differs from Figure 1¹⁰⁵ in that it differentiates between pornography related John Doe litigation and other John Doe litigation.

¹⁰⁵ Part I, *Supra*.

Figure 4: Percentage of John Doe Law Suits in Selected Districts, 2010 to 2013

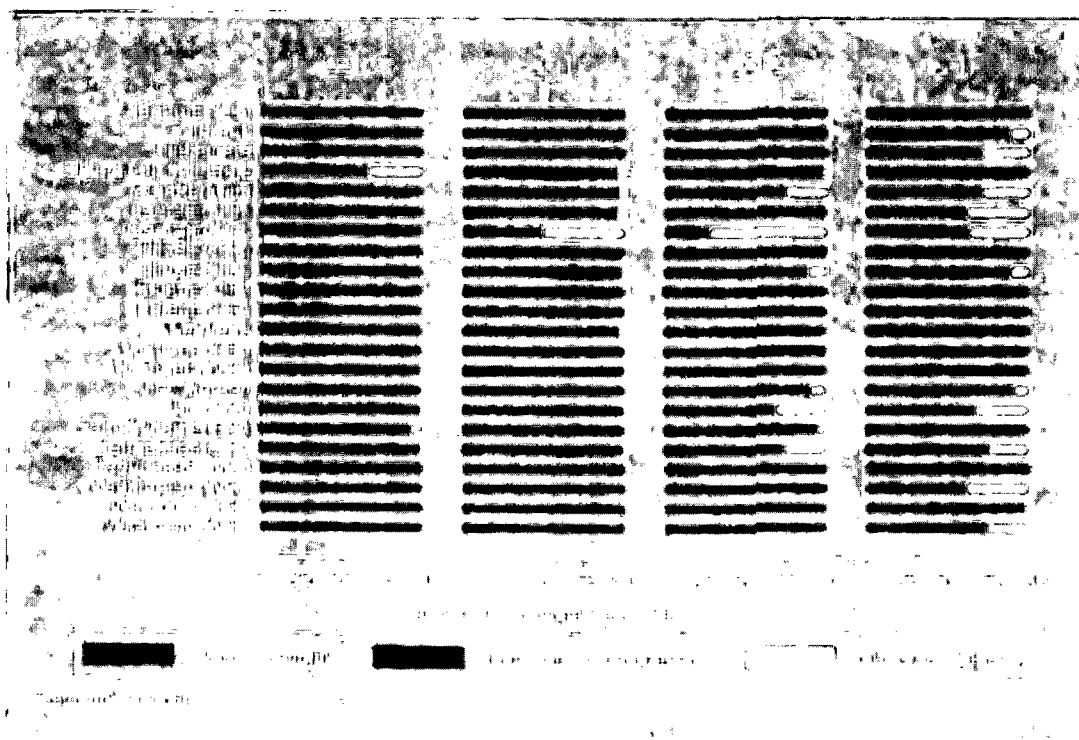


Figure 4 takes a selection of the same data and shows how the relative frequency of Pornography focused John Doe litigation has changed in selected districts over the last four years. The 22 districts shown are those with had the highest ratios of pornography filings in 2013. There were almost no John Doe pornography cases until 2010, yet by 2013 these cases made up more than half of all copyright filings in 19 federal districts in 2013.

Why so much pornography? The prevalence of pornography in MDJD lawsuits could be attributable to characteristics of the adult entertainment industry itself. It might be, for example, that the industry is generally more innovative and less convention bound and so is simply the first to adopt what may soon be a broader trend.¹⁰⁶ Indeed, anecdotal reports of the increasing appearance of low-budget and independent films in the MDJD format suggests that the appeal of MDJD litigation may be expanding. A related explanation would be that the producers of pornography are less concerned about negative publicity than other creative industries.¹⁰⁷ A closer look into the mechanics of MDJD litigation suggests two additional structural explanations.

The first structural explanation is simply that the economics of copyright trolling are particularly well suited to pornography because the plaintiff can threaten accused

¹⁰⁶ Peter Johnson, *Pornography Drives Technology: Why Not to Censor the Internet*, 49 Fed. Comm. L.J. 217 (1996) (discussing pornography's role at the vanguard of new technology).

¹⁰⁷ This seems entirely speculative.

infringers with public exposure in addition to statutory damages. This additional incentive to settle can fundamentally transform the viability of such an enterprise. As noted previously, the profitability of MDJD lawsuits depends on keeping costs low and recovery high.

Recall that $Profit = N(PY - C_v) - C_f$. Hypothetically, if the plaintiff faces fixed costs of \$100,000 and an average variable cost of \$1000 per defendant, MDJD litigation would be unprofitable if the plaintiff achieved an average settlement of \$3000 ($P=3000$) and a yield of 30% ($Y=0.3$) in a lawsuit targeting 5000 IP addresses ($N=5000$). This would result in a loss of \$150,000 on an investment of \$5.1 million.¹⁰⁸ But assuming that the threat of public exposure as a consumer of pornography motivates more people to settle more quickly, the enterprise would become profitable to the tune of \$3.9 million simply by increasing the yield from 30% to 60%.¹⁰⁹ In short, one reason that the MDJD model has been employed more in relation to pornography than an other subject matter is that the social stigma relating to pornography, or particular types of pornography, increases both yield (Y) and payoff (P) while keeping the plaintiff's variable costs (C_v) low.

The second structural explanation for the prevalence of pornographic subject matter in copyright trolling is that a significant amount of this litigation has been initiated by a small number of entrepreneurial lawyers and plaintiffs.¹¹⁰ The most well-known of these is the Prenda Law firm.¹¹¹ A group of entities associated with Prenda Law have amassed millions of dollars in settlements in MDJD lawsuits.¹¹² According to media reports and court records, Prenda has leveraged this fear of social stigma associated with downloading pornography by posting the names of defendants who do not settle on its website, along with a link to the lawsuit.¹¹³ Lawyers in an unrelated case were censured in several cases for attaching an erroneous exhibit listing several other adult films that

¹⁰⁸ $Profit = N(PY - C_v) - C_f = 5000(3000 \cdot 0.30 - 1000) - 100,000 = -150,000$.

¹⁰⁹ $Profit = N(PY - C_v) - C_f = 5000(3000 \cdot 0.60 - 1000) - 100,000 = 3,900,000$.

¹¹⁰ The appearance of the same counsel and making virtually identical claims and using virtually identical filings has not gone unnoticed by the courts. See e.g. *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 155 (D. Mass. 2013).

¹¹¹ *Guava, LLC v. Does 1-5*, 1:12-CV-8000, 2013 WL 3270663 (N.D. Ill. June 27, 2013). ("The aggressive tactics of Guava's counsel, Prenda Law, in litigating John Doe lawsuits have been widely reported and acknowledged by courts, including those in Illinois and California.") See also, Joe Mullin, "'Porn troll' Prenda Law sanctioned in defamation lawsuit" *Ars Technia*, January 23, 2014 (<http://arstechnica.com/tech-policy/2014/01/porn-troll-prenda-law-sanctioned-in-defamation-lawsuit/>).

¹¹² Kashmir Hill "How Porn Copyright Lawyer John Steele Has Made A 'Few Million Dollars' Pursuing (Sometimes Innocent) 'Porn Pirates'" *FORBES* (October 15, 2012). Note that the Prenda legal team appears to have begun under the firm title Steele Hansmeier PLLC and has now changed its name to the Anti-Piracy Law Group.

¹¹³ Claire Suddath, "Prenda Law, the Porn Copyright Trolls", *BUSINESS WEEK*, May 30, 2013 (available at <http://www.businessweek.com/articles/2013-05-30/prenda-law-the-porn-copyright-trolls>)

defendants were alleged to have downloaded that were unrelated to the litigation.¹¹⁴ All of these techniques are aimed at forcing settlement by leveraging the threat of exposure.

Attorneys associated with Prenda have been ruthless in their pursuit of profits and have also been sanctioned for various forms of deceit and unethical behavior.¹¹⁵ Defendants in a Florida case involving Prenda have presented evidence that someone inside the firm was "seeding" its own content, i.e., making pornography available for illegal download in the first place, in an attempt to induce copyright infringement.¹¹⁶ Prenda lawyers have also been accused of colluding in litigation,¹¹⁷ lying to the court,¹¹⁸ forging documents¹¹⁹ and identity theft.¹²⁰

The influence of Prenda and entities associated with it can be seen on the following two tables which list the top 20 plaintiffs in copyright suits against John Does. Table 1 lists the top 20 plaintiffs between 2001 and 2013 ranked according to the total number of John Doe defendants. Table 2 lists the top 20 plaintiffs between 2010 and 2013, ranked according to the number of suits filed.

¹¹⁴ Malibu Media, LLC, Doe, subscriber assigned IP address 184.58.186.212 and related cases (Case Nos. 13-C-536, 13-C-544, 13-C-779 (E.D. Wis. December 12, 2013); *Malibu Media, LLC v. Doe*, 2013 WL 5276081 (E.D. Wis. Sept. 17, 2013); see also *Malibu Media LLC v. Doe*, 2013 WL 4821911 (W.D. Wis. Sept. 10, 2013) (Judge Conley's Order imposing sanctions). MALIBU MEDIA, LLC v. MCSWEENEY et al, INSD (Motion for fees/costs against Malibu Media – Also 2 defaults v. 2 Does for \$67.5K), 1:12-cv-00842; *Malibu Media LLC v. Doe*, ILND (80-Year Old Woman), 2:13-cv-00097.

¹¹⁵ *Lightspeed Media Corp. v. Smith*, CV 12-889-GPM, 2013 WL 6225093 (S.D. Ill. Nov. 27, 2013) ("the Court has no doubt that Duffy, Steele, and Hansmeier are closely associated and acted in concert to file and prosecute this frivolous lawsuit.") *Ingenuity 13 LLC v. John Doe*, 2:12-CV-8333-ODW JCX, 2013 WL 1898633 (C.D. Cal. May 6, 2013) (finding that "the Principals engaged in vexatious litigation designed to coerce settlement;" that the "Plaintiffs have demonstrated their willingness to deceive not just this Court, but other courts where they have appeared," and awarding sanctions against lawyers Steele, Hansmeier, Duffy and Gibbs, the Prenda Law and their clients AF Holdings and Ingenuity 13 based on the "Plaintiffs' brazen misconduct and relentless fraud.")

¹¹⁶ Cyrus Fariyar, "Prenda seeded its own porn files via BitTorrent, new affidavit argues" ARS TECHNICA (June 3, 2013).

¹¹⁷ Mike Masnick, "'Defendant' In Prenda Law Case Reveals He Agreed To Take A Dive", TECHDIRT. Retrieved April 11, 2013. (January 25, 2013).

¹¹⁸ See Judge Wright's findings of fact in *Ingenuity 13 LLC v. John Doe*, 2:12-CV-8333-ODW JCX, 2013 WL 1898633 (C.D. Cal. May 6, 2013).

¹¹⁹ *Id.*

¹²⁰ *Id.*

Table 1: Top 20 Copyright John Doe Plaintiffs 2001–2013
By total number of defendants

Litigant	Cases Filed	Fewest defendants	Most defendants	Total defendants	Percentage of total
Patrick Collins, Inc	224	1	3757	11460	12.2%
Third Degree Films	56	1	3577	8288	8.8%
New Sensations, Inc	17	1	1768	7502	8.0%
Braun	9	1	7098	7106	7.6%
Digital Sin, Inc	19	1	5698	6476	6.9%
Malibu Media, LLC	1367	1	81	5938	6.3%
Discount Video Center, Inc	3	1	5041	5071	5.4%
On The Cheap, LLC	1	5011	5011	5011	5.3%
West Coast Productions	24	1	2010	4761	5.1%
Diabolic Video Productions, Inc	2	2099	2099	4198	4.5%
SBO Pictures	13	1	3036	3637	3.9%
Zero Tolerance Entertainment	6	1	2943	3128	3.3%
Openminded Solutions, Inc	17	1	2925	2979	3.2%
Third World Media, LLC	7	1	1568	2977	3.2%
Contra Piracy	1	2919	2919	2919	3.1%
Hard Drive Productions, Inc	57	1	1000	2853	3.0%
Media Products, Inc	24	1	1257	2550	2.7%
Tcyk, LLC	119	1	131	2528	2.7%
Combat Zone	35	1	1037	2165	2.3%
Arista Records	301	1	143	2123	2.3%
<i>Total</i>	<i>2302</i>			<i>93670</i>	<i>100%</i>

* Only Contra Piracy and Arista Records are not related to pornography. The 297 Arista Records suits were filed between 2004 and 2008.

The only Prenda-related entity listed on Table 1 is Hard Drive Productions, Inc.,¹²¹ however Prenda-related entities claim 5 out of the top 20 positions on Table 2. It is important to note that the methodology of counting John Doe defendants is under-inclusive. Doe numbers were derived from the case captions them-selves—e.g. “*Digital Sin, Inc v. Does 1-208*” would be counted as 208 John Doe defendants, but “*Digital Sin, Inc v. Does*” or “*Digital Sin, Incorporated v. Unknown Parties*” would be counted as a single John Doe defendant.

¹²¹ According to media reports, Hard Drive Productions stopped working with Prenda in late 2012. See, Claire Suddath, “*Prenda Law, the Porn Copyright Trolls*”, BUSINESS WEEK, May 30, 2013 (available at <http://www.businessweek.com/articles/2013-05-30/prenda-law-the-porn-copyright-trolls>)

Table 2: Top 20 Copyright John Doe Plaintiffs 2010–2013
By number of suits filed

Litigant	Cases Filed
Malibu Media, LLC	1367
Patrick Collins, Inc	224
AF Holdings, LLC*	138
Tcyk, LLC	119
Ingenuity 13, LLC*	66
<i>Voltage Pictures</i> [°]	64
K-Beech, Inc	62
Quad International, Inc	59
Hard Drive Productions, Inc*	57
Third Degree Films	56
Killer Joe Nevada, LLC	49
<i>Breaking Glass Pictures</i> [°]	41
<i>John Wiley & Son</i> [°]	40
Combat Zone	35
<i>Bait Productions Pty Ltd</i> [°]	34
<i>Zambezia Film</i> [°]	30
First Time Videos, LLC*	27
West Coast Productions	24
Media Products, Inc	24
Boy Racer, Inc*	21
<i>Total</i>	<i>2537</i>

*Entities associated with the Prenda Law Firm at some time.

[°]Not related to pornography.

The significance of repeat players may also explain the uneven geographic distribution of MDMJ lawsuits.¹²² Figure 5, below, shows the raw numbers for John Doe pornography and other John Doe copyright litigation, by district court. Measured by the number of John Doe defendants, the Northern District of Illinois is the clear leader in pornography related copyright trolling, whereas the District of Connecticut is the venue of choice for non-pornography trolling.

¹²² The appearance of the same counsel and making virtually identical claims and using virtually identical filings has not gone unnoticed by the courts. See e.g. *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 155 (D. Mass. 2013).

Figure 5: John Doe Copyright Lawsuits 2010–2013
Selected Districts



The copyright troll-pornography nexus illustrates how a general system of incentives can lead to unintended results. Pornography may be no better and no worse than other genres, but it is uniquely well suited to exploit the litigation incentives of our current copyright system. Copyright is meant to establish market-based incentives for the production of creative works, however, for a particular breed of plaintiff, the litigation incentives established by permissive joinder and statutory damages are more attractive.

No doubt, some readers will be concerned that pornography giving copyright litigation a bad name, but the conduct of plaintiff's lawyers described in a number of copyright trolling cases might suggest the reverse: copyright litigation is sullyng the reputation of pornography.

III. REFORMS

A. The Normative Foundations for Reform

Some question whether the system really works but that debate is entirely beyond the scope of this Article just as it is beyond the mandate of the judges who must apply the law.¹²³ For purposes of a rational discussion about copyright trolling, as opposed to a wholesale reappraisal of the copyright system, we should accept the central dogma of copyright that exclusive rights are an effective way to provide incentives for the creation and distribution of expressive works.¹²⁴ In less abstract terms this means, at the very least, accepting the premise that unauthorized file sharing is a civil wrong deserving of a remedy: there is no legal justification for someone who can pay a reasonable price for legitimate access to *Game of Thrones* to instead download it via BitTorrent.¹²⁵ In short, the problem with MDJD lawsuits is not that individual infringers face the risk of detection and sanction—an unenforceable copyright law would provide no incentives.

The primary problems with MDJD litigation relate to the fairness of the judicial process. MDJD suits allow accusations of infringement to be made based on a minimal investigation of the facts. Defendants in these cases are often subject to leverage that crosses the line into extortion, and effectively denied an opportunity to defend themselves. Once an ISP names an individual, the burden of proof is effectively reversed. This

¹²³ For a representative sample of the literature, see Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569 (2009); Lydia Pallas Loren, *The Pope's Copyright? Aligning Incentives with Reality by Using Creative Motivation to Shape Copyright Protection*, 69 LA. L. REV. 1 (2008); Diane Leenheer Zimmerman, *Copyrights as Incentives: Did We Just Imagine That?*, 12 THEORETICAL INQUIRIES L. 29 (2011).

¹²⁴ The utilitarian foundation of copyright can be traced back to its origins in England the 1710 Act "for the encouragement of learning, by vesting the copies of printed books in the authors or purchasers of such copies, during the times therein mentioned" or the Statute of Anne as it is now known. This purposive conception of Copyright is also clearly reflected in the U.S. Constitution which provides that "The Congress shall have Power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." U.S. Const., Art. I, Sect. 8, cl. 8. The Supreme Court has repeatedly observed that "the primary objective of copyright is not to reward the labor of authors, but to promote the Progress of Science and useful Arts." *Feist v. Rural Telephone at 350* (quoting Art. I, § 8, cl. 8., citing *Twentieth Century Music Corp. v. Aiken*, 422 U. S. 151, 156 (1975)). The rights of authors are not the ends of the copyright system, but they are an important means by which those ends are achieved. As the Court observed in *Harper & Row* "By establishing a marketable right to the use of one's expression, copyright supplies the economic incentive to create and disseminate ideas." *Harper & Row, Publishers, Inc. v. Nation Enterprises* 471 U.S. 539, 558 (1985). See also *Eldred v. Ashcroft*, 537 US 186 (2003). See generally William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989).

¹²⁵ Unauthorized file-sharing is not fair use. See *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, 545 U.S. 913, 125 S.Ct. 2764, 162 L.Ed.2d 781 (2005); *A & M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir.2001); *BMG Music v. Gonzalez*, 430 F.3d 888, 890 (7th Cir.2005).

reversal takes place because, unless the defendant has a lawyer willing to work on contingency, the cost of establishing his innocence vastly exceeds the settlement payoffs demanded by plaintiffs. Fee shifting is available for the successful defendant in copyright cases, but it is not guaranteed,¹²⁶ and it does not level the playing field. The innocent defendant must calculate the expected value of litigation versus settlement with reference to the small probability that the plaintiff will prevail. If the defendant prevails and is awarded attorney fees, his¹²⁷ profit is zero at best.¹²⁸ If the defendant loses, his combined liability for statutory damages and attorney fees could easily exceed \$100,000. Even if the chance of this catastrophic loss is only 5%, the defendant's expected loss is \$5,000. The potential for six-figure statutory damage awards compounds the problem of litigation costs by making the downside risk for a defendant who fails to establish his innocence untenable on most objective risk-reward calculations. For the innocent and guilty alike, the rational response to a letter of demand in these circumstances is to negotiate a settlement. In this context, the discovery orders that link IP addresses to personal individual information are little more than a judicially sanctioned hunting license.

Arguably, another problem with MDJD lawsuits is that they lower the cost of copyright enforcement too far. Although some enforcement is required for copyright's incentives to function, it is wrong to assume that more enforcement is always better. The idea that copyright should always be enforced equivalent to the suggestion that every trespass should lead to litigation. Like other forms of property, copyright is private right that creates the option of enforcement. We expect landholders and copyright owners alike to enforce their rights when the private benefits of doing so outweigh the private costs. Litigation invokes significant public resources and has potentially significant public costs. Attaching a positive cost to litigation through filing fees or other procedural mechanisms can act as an important screening mechanism that deters the marginal complaint and those with trivial claims. Filing fees and the like help allocate judicial resources to more valuable claims.

B. Reform Proposals

With these normative foundations in place, we can now consider some concrete reform proposals.

1. Reasonable Statutory damages

Copyright law's statutory damages framework leads to awards that are unreasonably high in contexts such as unauthorized file-sharing. In the standard

¹²⁶ 17 U.S.C. § 505 allows for attorney's fees to be awarded to the prevailing party at the court's discretion. The Supreme Court has held that prevailing plaintiffs and prevailing defendants must be treated alike under Section 505. *Fogerty v. Fantasy, Inc.*, 510 U.S. 517 (1994).

¹²⁷ Perhaps because of the close association between copyright trolling and pornography, the vast majority of defendants appear to be men.

¹²⁸ It is not truly zero, because the defendant must finance the litigation and the cost of money (whether interest or opportunity cost) is not part of the attorney fee calculation. If the defendant's lawyer works on contingency, the cost is truly zero.

BitTorrent case, statutory damages are likely to amount to tens of thousands of dollars, if not hundreds of thousands of dollars.¹²⁹ The threat of statutory damages makes resistance to even quite unreasonable plaintiff demands irrational from an economic perspective. At their current levels, statutory damages are a tool of coercion that can be wielded just as effectively against the innocent as the guilty.

Ideally, reform of statutory damages would come from Congress, but even if Congress continues to ignore the problems with statutory damages,¹³⁰ courts have a statutory and constitutional obligation to oversee them.¹³¹ Courts should recognize that in the typical BitTorrent lawsuit, statutory damages are punitive: it is hard to see that damages which clearly exceed any plausible measure of compensation or restitution could be considered to be anything else.¹³² The fact that statutory damages are punitive does not mean that there is no place for them. On the contrary, it is quite likely that punitive damages are necessary as a deterrent to illegal file-sharing. Like parking violations and cheating on taxes, the probability of an individual file-sharer being detected is low but the cumulative harm of widespread infringement may be significant.¹³³ Where the probability of detection is low, punitive statutory damages tilt the cost-benefit calculation of buying versus stealing back in the direction of legal acquisition. Where statutory damages exceed the amount required to compensate the plaintiff for the wrong suffered, they should be justified under some rational theory of deterrence and subject to the same constitutional constraints as other forms of punitive damages. Currently, neither is the case. For example, the district court in *UMG Recordings, Inc. v. MP3.com, Inc.* awarded \$53 million in statutory damages and attorney fees against a technology startup

¹²⁹ *Capitol Records v. Thomas-Rasset* 579 F. Supp. 2d 1210, 1213, 1227 (D. Minn. 2008); *Sony BMG Music Entertainment v. Tenenbaum* 593 F. Supp. 2d 319 (D. Mass. 2009).

¹³⁰ Canada recently amended its copyright law to reduce the range of statutory damages to a maximum of \$5000 for non-commercial infringement. Copyright Modernization Act 2012 §38.1(1)(b). The current administration is clearly in favor of statutory damages in copyright law. The United States both encourages and mandates the adoption of statutory damage rules in copyright law through bilateral and regional trade agreements and through the Special 301 review process. See, Pamela Samuelson et al, *Statutory Damages: A Rarity in Copyright Laws Internationally, But for How Long?* 60 J. COPYRIGHT SOC'Y U.S.A. (2013).

¹³¹ Section 504 expressly states within the applicable range, the award of statutory damages should be "as the court considers just". 17 U.S.C § 504. *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 416 (2003) ("The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor.")

¹³² Tellingly, § 504(c) of the 1976 Act omits the part of its 1909 Act predecessor that provided that statutory damages are not intended as a penalty. Compare § 504(c) 1976 and § 101(b) 1909.

¹³³ There is an extensive literature that attempts to establish and quantify the effect of file sharing. Proving causality and estimating the size of any effect is extremely difficult because although music sales declined sharply after Napster emerged in 1999, this decline was at least partially attributable to the end of the CD replacement cycle, a sustained economic downturn in much of the Western world, and the increased competition for entertainment spending attributable to the Internet and the games. See generally, Stan J. Liebowitz, *File Sharing: Creative Destruction or Just Plain Destruction?*, 49 J.L. & ECON. 1, 15-16 (2006); Alejandro Zentner, *Measuring the Effect of File Sharing on Music Purchases*, 49 J.L. & ECON. 63, 65-66 (2006). But see, Felix Oberholzer-Gee & Koleman Strumpf, *The Effect of File Sharing on Record Sales: An Empirical Analysis*, 115 J. POL. ECON. 1, 3 (2007) (finding no causality between declining music sales and peer-to-peer file-sharing).

that based its music streaming service on an aggressive (and ultimately flawed) reading of the fair use doctrine.¹³⁴ Rational deterrence theory suggests that where the probability of detection is low, damages must be higher in order to reduce the expected gains from law-breaking.¹³⁵ However, the probability that MP3.com would be detected was 100%, as its operation was no secret and was bound to attract the attention of the record industry. The damages/profits accrued by the time case went to trial were not substantial. Given the large number of copyrights infringed in that case, even the minimum statutory damages award plus attorney fees would have provided substantial deterrence and yet the trial judge saw fit to award damages well in excess of the statutory minimum.¹³⁶ Cases like *MP3.com* and *Capitol Records v. Thomas-Rasset* are also difficult to reconcile with the U.S. Supreme Court's guidance that "few awards [of punitive damages] exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."¹³⁷ Copyright scholars have addressed the possible unconstitutionality of statutory damages; courts have not yet seen fit to apply the constitutional standards of tort litigation to copyright law.¹³⁸

The imposition of statutory damages should take into account the need for deterrence, but the courts must recognize that the level of damages justified by deterrence has logical and constitutional limits. The fact that statutory damages for file-sharing can exceed the financial penalty for kidnapping violates the principle of marginal deterrence as well as common decency.¹³⁹ Copyright owners should not be indifferent to public perceptions of the fairness of copyright penalties. Without completely discounting the effect of deterrence, the weight of evidence in sociology and behavioral psychology suggests that compliance with the law is much more normative than instrumental.¹⁴⁰ Tom

¹³⁴ *UMG Recordings, Inc., et al v. MP3.com, Inc.*, Docket No. 1:00-cv-00472 (S.D.N.Y. Jan 21, 2000) Nov. 14 2000 (Final Judgment and Order Nov. 14, 2000).

¹³⁵ Gary Becker, *Crime and Punishment: An Economic Approach*, in *ESSAYS IN THE ECONOMICS OF CRIME AND PUNISHMENT* 1, 24-34 (Gary S. Becker & William M. Landes, eds., 1974)

¹³⁶ *UMG Recordings, Inc., et al v. MP3.com, Inc.*, Docket No. 1:00-cv-00472 (S.D.N.Y. Jan 21, 2000) Nov. 14 2000 (Final Judgment and Order Nov. 14, 2000)

¹³⁷ *State Farm Mutual Automobile Ins. Co. v. Campbell*, 538 U.S. 408, 123 S.Ct. 1513, 1524, 155 L.Ed.2d 585 (2003). The Court also noted that "four times the amount of compensatory damages might be close to the line of constitutional impropriety." *Id.*, citing *Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24 (1991), and *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 581 (1996).

¹³⁸ See, e.g., *Sony BMG Music Entertainment v. Tenenbaum*, 719 F.3d 67, 70-72 (1st Cir. 2013) (an award of \$675,000 for infringement of thirty songs did not offend due process); *Zomba Enterprises, Inc. v. Panorama Records, Inc.*, 491 F.3d 574, 586-88 (6th Cir. 2007) (rejecting Due Process Clause challenges and upholding a statutory damage award of \$806,000, representing a 44:1 ratio of statutory to actual damages), cert. denied, 553 U.S. 1032 (2008); *Capitol Records, Inc. v. Thomas-Rasset*, 692 F.3d 899, 907-10 (8th Cir. 2012) (upholding an award of \$222,000 in statutory damages for infringement of twenty-four songs), cert. denied, 133 S. Ct. 1584 (2013); *Lowry's Reports, Inc. v. Legg Mason, Inc.*, 302 F. Supp. 2d 455, 459-60 (D. Md. 2004) (rejecting a due process challenge to a \$19 million jury verdict for copyright infringement where the defendant argued that actual harm was limited to \$59,000).

¹³⁹ The United States Sentencing Guidelines §5E1.2 establishes a fine range of \$17,000 to \$175,000 for crimes at a base offense level from 23-24, such as kidnapping. See U.S.S.G. §2A4.1. and § 5E1.2

¹⁴⁰ See generally TOM R. TYLER, *WHY PEOPLE OBEY THE LAW* (1990).

Tyler's canonical research found that obedience to the law is largely a function of the perception that the law is legitimate, and that legitimacy in turn is significantly influenced by perceptions of fairness.¹⁴¹ Persuading ordinary consumers who would pay for creative content in a world without illegal file-sharing to continue to do so in spite of the existence of BitTorrent means appealing to their sense of fairness as well as their fear of sanctions. Unreasonable and arbitrary sanctions undermine the normative case for copyright compliance. Copyright owners who want to reinforce their normative appeals with deterrence would do far better to increase the perceived probability of detection than to pursue million-dollar verdicts in sporadic show trials.¹⁴² To the extent that high levels of statutory damages are justified under a theory of rational deterrence, they must still comply with the constitutional limits of the Due Process clause. In *BMW of North America, Inc. v. Gore*, the U.S. Supreme Court indicated that punitive damages are likely to violate the constitutional guarantee of Due Process if they exceed compensatory damages by a ratio of more than 10 to 1.¹⁴³ In the subsequent case of *State Farm Mutual Automobile Ins. Co. v. Campbell*, the Court noted that "four times the amount of compensatory damages might be close to the line of constitutional impropriety."¹⁴⁴ It is not clear that the Court's guidance should extend to every context,¹⁴⁵ but it does suggest that even in the absence of legislative reform, district court judges have a duty to ensure that statutory damages do not exceed the proportionality constraints of the Due Process clause. In addition to the general duty to uphold the Constitution, the Copyright Act clearly states that any award should be an amount that the court "considers just."¹⁴⁶

The range of statutory damages available in ordinary file-sharing cases should be reduced by Congress or circumscribed by the courts. Obviously, selecting any particular number may appear arbitrary, but we can at least move toward a rational basis for statutory damages by comparing file sharing to other violations of the law that may easily go undetected. My specific proposal is that the constitutionally plausible range of statutory damages for a first-time defendant found liable for illegal file-sharing should be between \$250 and \$3000. The lower boundary is equivalent to the fine for parking in a handicapped space.¹⁴⁷ The upper boundary is in the ballpark of fines imposed for driving under the influence.¹⁴⁸ According to the Centers for Disease Control, almost 30 people in

¹⁴¹ *Id.* at 25.

¹⁴² *Capitol Records v. Thomas-Rasset* 579 F. Supp. 2d 1210, 1213, 1227 (D. Minn. 2008); *Sony BMG Music Entertainment v. Tenenbaum* 593 F. Supp. 2d 319 (D. Mass. 2009).

¹⁴³ *State Farm Mutual Automobile Ins. Co. v. Campbell*, 538 U.S. 408 (2003).

¹⁴⁴ *Id.* (citing *Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24 (1991), and *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 581 (1996).)

¹⁴⁵ *Mathias v. Accor Economy Lodging, Inc.*, 347 F. 3d 672 (7th Cir. 2003).

¹⁴⁶ 17 U.S.C. § 504(c) (2006).

¹⁴⁷ Vehicles parked in a space reserved for persons with disabilities without properly displaying disability license plates and/or a parking placard may be fined a minimum of \$250. 625 ILCS 5/11-1301.3.

¹⁴⁸ In lieu of more systematic data a recent example: a Chicago local television news reporter pled guilty in February 2014 to driving under the influence and was ordered to pay a \$1,700 fine with one year's supervision. Prosecutors dropped other charges, including battery, leaving the scene of an accident and child endangerment. The reporter's drink-driving was detected after a minor traffic accident at a Taco Bell.

the United States die in motor vehicle crashes that involve an alcohol-impaired driver every day and the annual cost of alcohol-related crashes totals more than \$51 billion.¹⁴⁹ There are no reported incidents of death by file-sharing. This range should not be exceeded even for multiple acts of infringement unless the plaintiff can establish that damages beyond the range are necessary for either compensation or deterrence.¹⁵⁰

Limiting the range of statutory damages available in Internet file-sharing cases would not significantly detract from general deterrence campaigns like those of the RIAA.¹⁵¹ The prospect of nontrivial sanctions combined with an award of attorney's fees should still provide a powerful incentive for accused infringers who are in fact liable to admit their wrongdoing and settle quickly. However, the amounts at stake are not so great that no reasonable person could ever be expected to defend themselves against an erroneous accusation.

Reforming statutory damages would allow copyright owners to continue to use litigation to deter infringement and to steer consumers toward the legitimate market, but it would make litigation as an independent revenue stream less attractive. This is not just an economic reform; it may also be necessary to protect the integrity of the judicial system. Currently, the prospect of high statutory damages unrelated to any assessment of harm sounds like easy money. There may be plaintiffs and lawyers pursuing in MDJD lawsuits as a revenue stream who are fine upstanding people, but there is substantial evidence that the lure of easy money in the form of statutory damages has attracted those with dubious ethics and a propensity for cutting corners.¹⁵² In the context of MDJD suits, the threat of massive statutory damages gives plaintiffs and their attorneys enormous leverage with no accountability. By divorcing statutory damages from either compensation or deterrence, modern copyright law has extended an invitation to blackmail and abuse of process that has been eagerly accepted. That invitation should be revoked.

2. Denying Joinder, Severing Cases

A second option for reform is to simply deny joinder (sever cases) as indeed many courts have done.¹⁵³ In practical terms, denying joinder increases the plaintiff's cost of

parking lot. Clifford Ward "TV reporter pleads guilty in DUI case," CHICAGO TRIBUNE, February 5, 2014, Pg. 7

¹⁴⁹ CENTERS FOR DISEASE CONTROL AND PREVENTION, *Injury Prevention & Control: Motor Vehicle Safety*, April 17, 2013 (available at http://www.cdc.gov/motorvehiclesafety/impaired_driving/impaired-driv_factsheet.html).

¹⁵⁰ Samuelson & Wheatland, *supra* note 40 at 509-10 (recommending that courts should also have the power to lower statutory damages when the award would be grossly disproportionate to the harm caused).

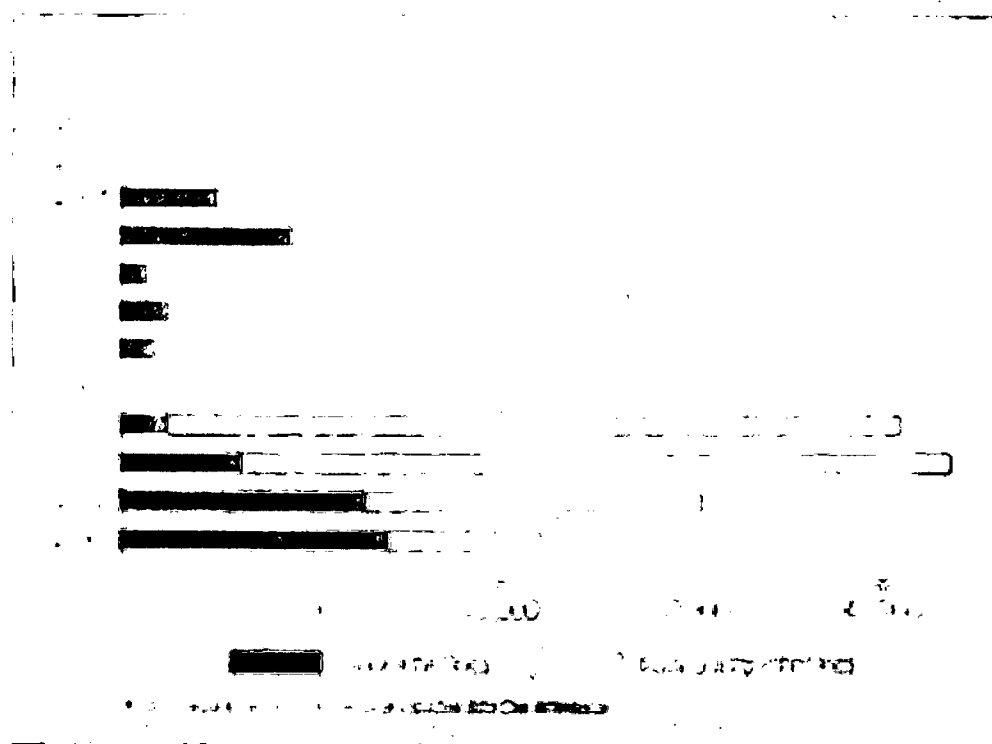
¹⁵¹ See *supra* notes 25 to 26 and accompanying text.

¹⁵² See *supra* note 99. See also *Righthaven LLC v. Democratic Underground, LLC*, 791 F. Supp. 2d 968, 979 (D. Nev. 2011) (Righthaven ordered to show cause why it should not be sanctioned for making "flagrant misrepresentation[s]" to the Court).

¹⁵³ See *supra* note 65 for examples of cases concluding joinder is impermissible or inappropriate.

enforcement: it adds a \$350 filing fee to the cost of proceeding against each defendant and it demands substantially more court time from the plaintiff's lawyers. Forcing disfavored plaintiffs to endure greater expense merely because the court doubts the social value of the underlying copyrighted work would be an abuse of discretion.¹⁵⁴ But refusing to allow plaintiffs to circumvent filing fees is legitimate because filing fees act "as a threshold barrier, albeit a modest one, against the filing of frivolous or otherwise meritless lawsuits."¹⁵⁵ Requiring individual filings, and thus filing fees, in BitTorrent infringement cases would destroy the financial appeal of litigation as a revenue source, but it would still leave the courthouse door open for litigation aimed at general deterrence or example setting. If allowing joinder makes abusive litigation tactics more likely, a court should use the discretion it has been given to take steps to curb such abuse. Disallowing joinder in MDJD cases would go a long way towards ensuring that litigation is used to protect the plaintiff's copyrights and not simply to monetize infringement.¹⁵⁶

Figure 6 Individual Doe Defendants in John Doe Copyright Cases 2001 – 2013



¹⁵⁴ *Bleistein v. Donaldson Lithographing Company*, 188 U.S. 239 (1903) (It would be a dangerous undertaking for persons trained only to the law to constitute themselves final judges of the worth of pictorial illustrations, outside of the narrowest and most obvious limits.)

¹⁵⁵ *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 166 (D. Mass. 2013) (quoting *In re Diet Drugs*, 325 F. Supp. 2d 540, 541 (E.D. Pa. 2004)).

¹⁵⁶ *Patrick Collins, Inc. v. Does 1-38*, 941 F. Supp. 2d 153, 166 (D. Mass. 2013) ("Furthermore, it will help to ensure that Patrick Collins is pursuing the Doe defendants for the purpose of protecting its intellectual property and not simply to coerce early settlements without any intention of litigating its claims to completion.")

Although up until now many courts have been willing to allow plaintiffs to join thousands of defendants in a single action, the data examined in this study shows signs of increasing judicial resistance. Figure 6, above, shows a conservative estimate of the number of Doe defendants in these cases.¹⁵⁷ As shown in Figure 6, the number of individual defendants peaked in 2010 and is been declining since. It is also apparent that although pornography related suits have accounted for an increased number of filings over the past four years, the raw numbers of John Doe defendants in pornography related suits has been declining since 2011. Although the data does not definitively establish as much, it does reinforce the observation that plaintiffs are reducing the number of defendants in each MDJD suit so as to make joinder seem more palatable and that this is in response to mounting judicial skepticism.¹⁵⁸

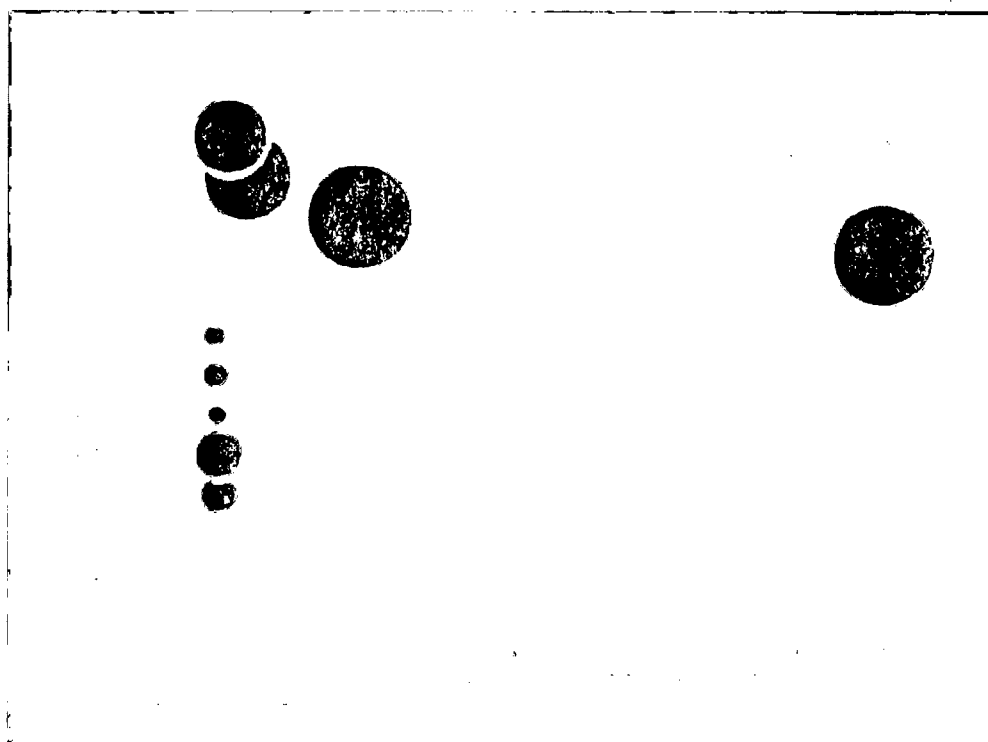
The opportunism associated with the current wave of MDJD suits is by no means confined to this format. Lawyers working in this area have reported that some plaintiffs have now abandoned the MDJD form for BitTorrent litigation and are now suing individual IP addresses and demanding significantly higher settlement amounts. Malibu Media, for example, now appears to filing suits against single IP addresses and demanding higher settlement amounts to compensate for its increased costs. Malibu Media has filed 197 such cases, 143 in 2013 alone. Lawyers working in this area report that Malibu Media's current settlements in the range of \$4000 to \$8000 for cases filed against individuals.

Figure 7 illustrates the average number of John Doe defendants per the suit filed on a year-by-year basis. The individual bowls in Figure 7 are scaled to reflect the total number of John Doe defendants in a given year. As illustrated, 2010 saw an extraordinary number of defendants, 41,025 to be exact, targeted in a mere 91 suits. In the following year 43,632 defendants were targeted, but these John Does were spread out over 435 individual suits. The total number of John Doe defendants fell in 2012 and again in 2013 to 30,666 and 22,239 respectively even as the number of lawsuits filed increased from 1211 to 1640. Thus although the average number of defendants per suit has decreased precipitously since 2010 this has been somewhat offset by a steady increase in filings. We should not expect this litigation environment to remain static. The broad trends revealed in the data are consistent with anecdotal observations that the serial litigators in this area have been adapting their tactics so that they are less dependent on permissive joinder.

¹⁵⁷ As noted previously, the methodology of counting John Doe defendants relies on the case captions themselves; it is likely to be under-inclusive. See *supra* note 120 and accompanying text.

¹⁵⁸ Note that the number of Doe defendants in each case is calculated based on the case title. This data will be supplemented with additional research into cases titled "Copyright Owner v. Does" in the near future. As a result the numbers reported herein will increase.

Figure 7 Average Number of Doe Defendants per Suit 2001 – 2013



One explanation of the decline in John Does per suit relates to personal jurisdiction. Rule 12(b)(2) permits dismissal of a claim based on lack of personal jurisdiction.¹⁵⁹ Personal jurisdiction can be established by either residency, minimum contacts or purposeful availment under most applicable state laws.¹⁶⁰ Defendants are in something of a Catch 22. They do not wish to be named individually, but until they are so named, a number of courts will not grant a motion to dismiss for lack of personal jurisdiction.¹⁶¹ Nonetheless, as courts have grown more skeptical of the propriety of these

¹⁵⁹ Fed. R. Civ. P. 12(b)(2).

¹⁶⁰ *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980) (Due Process requires the plaintiff to show that the defendant has "minimum contacts" with the forum, thereby ensuring that "the defendant's conduct and connection with the forum State are such that he should reasonably anticipate being haled into court there.")

¹⁶¹ See e.g., *First Time Videos, LLC v. Does 1-500*, 276 F.R.D. 241, 251 (N.D. Ill. 2011) ("Defendants cannot be dismissed under Federal Rule of Civil Procedure 12(b)(2) from a lawsuit to which they are not yet parties."); see also *Malibu Media, LLC v. Does 1-6*, 291 F.R.D. 191, 206 (N.D. Ill. 2013); *First Time Videos, LLC v. Does 1-76*, 276 F.R.D. 254, 259 (N.D. Ill. 2011); *MGCIP v. Does 1-316*, No. 10 C 6677, 2011 WL 2292958, at *2 (N.D. Ill. June 9, 2011). See, e.g., *London-Sire Records, Inc. v. Doe 1*, 542 F.Supp.2d 153, 180-181 (D.Mass.2008) ("premature to adjudicate personal jurisdiction" and permitting plaintiff to engage in jurisdictional discovery); *Sony Music Entm't, Inc. v. Does 1-40*, 326 F.Supp.2d 556, 567 (S.D.N.Y.2004) (evaluating personal jurisdiction premature without defendants' identifying information). But see *DigiProtect USA Corp. v. Does 1-240*, No. 10 Civ. 8760(PAC), 2011 WL 4444666, at *3 n. 3 (S.D.N.Y. Sept. 26, 2011) (dismissing complaint because of insufficient allegations of personal jurisdiction but noting that allegations were also insufficient to satisfy joinder requirements)

MDJD suits, plaintiffs have had to work harder to establish a credible basis for pleading personal jurisdiction.

Severing cases would obviously be inefficient if it required multiple judges to adjudicate the same issues, over and over again, for the exact same plaintiffs. However, there is no reason why cases could not be severed and then consolidated. The basis of consolidation could be (i) the plaintiff, (ii) the plaintiff law firm or even (iii) the plaintiffs' technical experts who log the IP addresses to begin with. Consolidation could be for limited purposes including assessing the validity and ownership of the copyrights at issue; determining the reliability of plaintiff's proffered expert; entertaining affirmative defenses that are potentially applicable in all cases. The 'it wasn't me' defenses should then proceed on an unconsolidated basis.

3. Conditional Joinder and Other Safeguards

Severing John Doe defendants and forcing the plaintiff to proceed on an individual basis is not the only possible solution. District court judges have inherent power to supervise litigation and substantial discretion in matters relating to both joinder and discovery. Even in the absence of legislative reform of statutory damages, district courts could use their considerable powers to impose safeguards on the discovery process and constrain the potential for abuse. Specifically:

(i) Joinder in MDJD actions should be subject to an undertaking by the plaintiff not to seek and not to threaten to seek statutory damages above a specified amount. For the reasons stated in the previous section, that range, at least for a first-time defendant, should be between \$250 and \$3000.¹⁶²

(ii) In addition, the court could appoint an independent attorney to supervise the discovery process and ensure that the names and addresses of individuals are not given over to the plaintiff until the initial round of "it wasn't me defenses" have been raised and investigated. This should bring to light any systematic errors by ISPs (or by the plaintiff) in identifying IP addresses or matching IP addresses to subscribers.

(iii) In the same vein, the court could provide defendants with the option of an express mini-trial on their "it wasn't me" defenses.

(iv) The court could grant defendants leave to proceed anonymously in order to protect their privacy, at least until liability has been definitively established.¹⁶³

¹⁶² Supra note 147 to 150 and accompanying text.

¹⁶³ TCYK, LLC v. Does, 2013 U.S. Dist. LEXIS 177765 ("Numerous courts have deemed it prudent to allow defendants to proceed by pseudonym during preliminary stages of copyright infringement proceedings, even when, as here, the material downloaded is innocuous, given the 'substantial possibility that the names turned over by ISPs will not accurately identify the individuals who actually downloaded or shared the copyrighted material.'" citing TCYK, LLC v. Does 1-87, 2013 U.S. Dist. LEXIS 95817, 2013 WL 3465186, at *4.)

These reforms and similar safeguards could reduce the threat of abusive litigation tactics while retaining the initial efficiency of the MDJD format.

IV. CONCLUSION

Although the problem of patent trolls has drawn more attention, we are currently witnessing an explosion of copyright trolling in U.S. federal district courts. The data in this Article shows that copyright trolling in the form of MDJD lawsuits has grown rapidly over the last decade and that much of the growth has taken place in the last four years. The data also shows that MDJD litigation is dominated by claims of infringement relating to pornographic films. As well as highlighting these particular trends and their implications, the results of this study have significant implications for the wider troll debate. What little attention has been paid to copyright trolls has largely focused on Righthaven and similar examples — this Article shows that these previous studies have missed the core of the copyright troll phenomenon.¹⁶⁴

The opportunism of copyright trolls is primarily directed towards statutory damages. As the Righthaven example shows, statutory damages can make the pursuit of otherwise inconsequential infringements extremely profitable, more profitable than licensing those uses in advance could ever have been. As the MDJD cases show, statutory damages stack the deck in favor of the plaintiff such that the underlying liability of the defendant is effectively irrelevant to the settlement calculation.

¹⁶⁴ Shyamkrishna Balganesh, *The Uneasy Case Against Copyright Trolls*, 86 S. CAL. L. REV. 723 (2013). See also, Brad A. Greenberg, *Copyright Trolls And Presumptively Fair Uses*, 85 U. COLO. L. REV. 53 (2014) (focusing on the application of fair use where copyright trolls attempt to exploit previously tolerated uses); Shyamkrishna Balganesh, *Copyright Infringement Markets*, 113 COLUM. L. REV. 2277 (2013) (arguing that an independent market for copyright claims could be beneficial).

TAB 3

DUFF & PHELPS

Damages Calculations in Intellectual Property Cases in Canada

Duff & Phelps Canada Limited Financial Litigation Support Group &
Norman V. Siebrasse*

June 2012

Damages Calculations in Intellectual Property Cases in Canada

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1.0 Introduction

While the focus of this article is damages in patent cases, the principles generally apply in trade-mark and copyright cases as well.¹ A damages award focuses on the loss suffered by the plaintiff. Damages principles in intellectual property cases are for the most part consistent with the modern understanding of general tort principles. This was emphasized by the English Court of Appeal in *Gerber Garment v. Lectra*: Infringement of a patent is a statutory tort; and in the ordinary way one would expect the damage recoverable to be governed by the same rules as with many or most other torts. We were referred to Halsbury's Laws of England ... to establish the elementary rules (1) that the overriding principle is that the victim should be restored to the position he or she would have been in if no harm had been done, and (2) that the victim can recover loss which was (i) foreseeable, (ii) caused by the wrong, and (iii) not excluded from recovery by public or social policy. The requirement of causation is sometimes confused with foreseeability, which is remoteness.²

Damages are typically measured by the difference between:

- (i) the financial position of the plaintiff as it would have been *but for* the infringement (i.e., if the infringement had not occurred); and
- (ii) the *actual* financial position of the plaintiff reflecting the negative consequences of the infringement.

The plaintiff bears the burden of proving its loss, and damages are compensatory, not punitive.³

1.1 Basic Principles

1.1.1 Causation and the "But For" Test

In summary, the plaintiff is presumptively entitled to all and only those losses in fact caused by the infringement.

The methods of calculating damages depend heavily on how the plaintiff would have exploited the intellectual property. As a first step, a court must determine the nature of the relevant market and a holistic understanding of its economics (often referred to as the "operating reality") in order to determine the "but for" position. This in turn enables the restoration of the plaintiff to where it would have been but for the infringement.

¹ Although damages for copyright infringement are "at large" and technically do not need to be specifically proved in detail by the plaintiff, as a practical matter the plaintiff usually should attempt such proof.

² *Gerber Garment Technology v. Lectra Systems Ltd.*, [1997] R.P.C. 443, at 452 (C.A.), per Staughton L.J.

³ These are general tort principles. In the patent context, see Lord Wilberforce in *General Tire v. Firestone*, [1976] R.P.C. 197, at 212 (H.L.), citing *Pneumatic Tyre v. Puncture Proof Pneumatic Tyre* (1899), 16 R.P.C. 209, at 215 (C.A.): "There are two essential principles in valuing that claim: first, that the plaintiffs have the burden of proving their loss; second, that the defendants being wrongdoers, damages should be liberally assessed but that the object is to compensate the plaintiffs and not punish the defendants."

Where the conclusion of the operating reality analysis is that "but for" the infringement the plaintiff would have made the sales in question, the plaintiff may be awarded lost profits on the sales it has lost. Where the plaintiff does not typically exploit the intellectual property, or cannot prove that it would have made the lost sale, the appropriate remedy is a reasonable royalty determined notionally for purposes of computing damages. Likewise, if the parties cannot establish lost profits or a standard licensing policy, the default remedy is the reasonable royalty, which recognizes that every sale by the infringing party is an illegal sale.

This scheme is diagrammed in Figure 1.



The "but for" requirement, which establishes causation, is central in intellectual property damages. Only the harm caused by an infringement is compensable as damages. Damages are measured by the difference between the actual position of the plaintiff and the position of the plaintiff but for the infringement: the position of the plaintiff had the infringement not occurred.

Damages Calculations in Intellectual Property Cases in Canada

The "but for" test requires an answer to the hypothetical question of what would have happened if the defendant had not infringed.⁴ The challenge in assessing what would have happened is that the market for products and services is dynamic, subject to the forces of competition and continuing innovation, and fluctuating in response to advertising, distribution, microeconomic factors internal to the business, and macro factors external to the business. The notion that the plaintiff, defendant and other market participants would have continued in exactly the same manner as they were just prior to the infringement is rarely sound. It is reasonable however to start with the market operating reality prior to the infringement and adjust it for how the market would notionally perform in the hypothetical "but for" scenario. Only well-thought-out models and related assumptions can simulate the "but for" result.

1.1.2 Relevance of Non-Infringing Alternatives

It is not just the plaintiff's alternatives and strategies that affect the "but for" scenario; often the defendant's or other market participants' hypothesized behavior but for the infringement will also affect the plaintiff's "but for" profits. For example, if the defendant was an established company with a good reputation and a sound product aggressively entering the market, it may be reasonable to infer that the defendant would have captured a portion of the market even without an infringing feature,⁵ while a new company without a reputation would have encountered more difficulty in making sales in the absence of an infringing feature.⁶

As a second example, it will typically be necessary to consider the non-infringing alternatives available to the defendant at the time of the infringement in determining what the defendant would most likely have done but for the infringement. A defendant with a very close non-infringing substitute available to it might well have captured a substantial part of the market with the non-infringing product that it in fact captured with the infringing product. On the other hand, if there is no close non-infringing substitute, the defendant might not have entered the market at all. The plaintiff's "but for" profits would be quite different in the two cases.

The 1888 decision of the House of Lords in *United Horse-Shoe & Nail Co. v. Stewart & Co.*⁷ addressed this point. The case is often cited (for example, in *Domco Industries*⁸) for the principles that damages are computed on the assumption that

⁴ See *Cadbury Schweppes v. FBI Foods*, [1995] 1 S.C.R. 142, at 73.

⁵ See *Meters Ltd. v. Metropolitan Gas Meters Ltd.* (1910), 27 R.P.C. 721, at 731 (Ch. D.) ("Meters trial"); aff'd. on this point, *Meters Ltd. v. Metropolitan Gas Meters Ltd.* (1911), 28 R.P.C. 157 (C.A.) ("Meters appeal").

⁶ See *Catnic Components v. Hill & Smith*, [1983] F.S.R. 512, at 522 (Pat. Ct.), per Falconer J.

⁷ *United Horse-Shoe & Nail Co. v. Stewart & Co.* (1888), 5 R.P.C. 260, at 264, L.R. 13 App. Cas. 401 (H.L.); *Meters*, supra note 5.

⁸ See *Domco Industries Ltd. v. Armstrong Cork Canada Ltd.* (1983), 76 C.P.R. (2d) 70, at 92 (F.C.T.D. – Prothonotary); var'd. (1986), 10 C.P.R. (3d) 53 (F.C.T.D.). See also *Jay-Lor International Inc. v. Penta Farm Systems Ltd.* 2007 FC 358, 59 C.P.R. (4th) 228, at 115, citing *Domco* for this proposition. However, it was clear on the facts in *Jay-Lor* that the defendant could not have competed as effectively without infringing.

the infringer had not entered the market at all,⁹ and that it is not relevant that the plaintiff would have been equally hurt by the defendant if the defendant had produced non-infringing products. On this point, however, *United Horse-Shoe* may be inconsistent with modern Canadian cases. The difficulty with the decision is that the defendant's non-infringing alternatives are clearly relevant in fact to what would most probably have happened but for the infringement. Ignoring this factor in a lost profits-only award is inconsistent with the general principle that the plaintiff is to be put in the position it would have in fact been in but for the infringement, as best this can be determined.¹⁰

The plaintiff in *United Horse-Shoe* held two patents related to machinery to save costs in the manufacture of horseshoe nails. Infringing nails had been made by the defendants. However, the evidence indicated that the savings from the use of the inventions subject to the first patent was small,¹¹ while the second patent was not practically useful and had been abandoned after a trial period.¹² The defendant argued that it would therefore have made equally competitive nails without infringing, by simply using the same methods it had previously used, and so would have made the same sales in any event. If this was true, the plaintiff's sales but for the infringement would have been exactly the same as they were in fact, and so the plaintiff would have no lost profits from lost sales.¹³ The Lord Ordinary at first instance held for the plaintiff.¹⁴ On appeal, the Scottish Court of Sessions reversed and rejected the plaintiff's claim for damages for lost sales, noting that on the facts it was established that the defendant would have competed equally well without infringing.¹⁵

⁹ See Collier J., *Doimco*, *ibid.*, at 61-62.

¹⁰ See U.S. Federal Trade Commission, "The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition", (March 2011) at p. 150 noting that "[t]o accurately replicate the market reward that the patentee would have earned by practicing its invention, the lost profits damages calculation must account for competition that the patentee's product would have faced if the infringer had sold a non-infringing alternative that did not incorporate the patented technology."

¹¹ *United Horse-Shoe and Nail Co, Ltd. v. John Stewart & Co.* (1886), 14 Court Sess. Cas. (4th) 266, at 275.

¹² *Ibid.*

¹³ In modern law, the plaintiff would therefore be eligible for a reasonable royalty on the infringing sales.

¹⁴ The Lord Ordinary ruled for the plaintiff, on the basis of a legal presumption that a patented invention must necessarily be useful. The Lord Ordinary noted that on the facts it appeared that the patented inventions did not provide a practical advantage, but he was of the view that because the patent was admitted to be valid, it must be presumed as a matter of law that the invention was indeed useful in saving waste, notwithstanding the evidence to the contrary. Court Sess. Cas., *supra* note 11, at 268.

¹⁵ Per Lord Adam, *ibid.*, at 276. However, the defendant did realize a small cost saving through the use of the invention. The Court of Session would have awarded £50 as the difference between the defendant's profits with and without the use of the invention. This is an application of the "differential profits" approach to an accounting of profits: see Duff & Phelps Canada Limited Financial Litigation Support Group, Norman V. Siebrasse, and Alexander J. Stack, "Accounting of Profits Calculations in Intellectual Property Cases in Canada" (June 2012).

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The House of Lords restored the award of the Lord Ordinary. The main basis for the House of Lords decision was that it was entirely irrelevant whether the defendant could in fact have competed successfully by non-infringing means.¹⁶ Lord Halsbury remarked, "[W]hat does it matter if it is ever so much established that the loss which the pursuers have sustained by the unlawful act of the defenders might also have been sustained by them under such circumstances as would give the pursuers no right of action? Your Lordships have to deal with the facts as they exist."¹⁷ Similarly, Lord Macnaghten stated, "It appears to be beside the mark to say that the respondents might have arrived at the same result by lawful means, and that, without infringing the appellants' rights, they might have produced a nail which would have proved equally dangerous a rival."¹⁸

Thus, in *United Horse-Shoe* it was found that, but for the infringement, the defendant would have competed successfully and made the same sales by non-infringing means; yet this was held to be irrelevant. Is this reconcilable with the modern "but for" approach?

The assessment of what hypothetically would have happened if the defendant had not infringed clearly includes the effects of third-party non-infringing competition. Why should it not include non infringing competition by the defendant? The fundamental inquiry is what would most probably have happened but for the infringement. This general principle provides no reason for distinguishing between the defendant and third parties.

The Supreme Court of Canada also looked to the hypothetical actions of the defendant in *Monsanto Canada Inc. v. Schmeiser*, an accounting of profits case.¹⁹ In *Schmeiser*, the defendant grew herbicide-resistant canola that infringed the plaintiff's patent.²⁰ However, there was no evidence to show that the defendant took advantage of the herbicide resistance by spraying, and he sold the canola seeds for crushing rather than as seed, so the sale price of the infringing canola was no higher than that for unpatented seed.²¹ The plaintiff argued that it was entitled to all of the defendant's actual profits regardless of whether the defendant gained material advantage from the infringement. However, the Supreme Court held that the plaintiff was entitled only to the difference between the profits the defendant actually made and those that he would have made but for the tort. On the facts, the defendant

¹⁶ Lord Watson also stated that "if these parts are not commercially useful... it would necessarily follow, either that the patent was void or that there was no substantial infringement which could entitle the patentee to an interdict." *United Horse-Shoe*, *supra* note 7, at 267.

¹⁷ *Ibid.*, at 409. Similarly, also per Lord Halsbury; *ibid.*, "I think it is nothing to the purpose to shew, if it is shewn, that the defenders might have made nails equally good and equally cheap without infringing the pursuers' patent at all."

¹⁸ *Ibid.*, at 416. Lord Watson's decision might be said to turn on the lack of proof of an alternative non-infringing process of equal efficacy (see his remarks at 414), but he did remark (at 412) that the principle in *Mowry v. Whitney* was "manifestly erroneous."

¹⁹ *Monsanto Canada Inc. v. Schmeiser*, 2004 SCC 34 [2004] 1 S.C.R. 902 (*Schmeiser*) at 102.

²⁰ Specifically, the plaintiff's patent covered genes that conferred herbicide resistance on the adult plant.

²¹ *Monsanto Canada Inc. v. Schmeiser* (2001), 12 C.P.R. (4th) 204, at 121 (F.C.T.D.); (2002), 21 C.P.R. (4th) 1, at 78 (F.C.A.).

would have made identical profits if he had not infringed, and the plaintiff was awarded zero profits.

United Horse-Shoe and Schmeiser raise the same basic issue: how to determine whether "profits"—profits of the defendant in an accounting of profits, lost profits of the plaintiffs in damages—are caused by the infringement.²² Following *Schmeiser*, in a damages case the possible non-infringing alternatives available to the defendant are relevant in determining causation and calculating the "but for" loss.

The decision of the U.S. Court of Appeals for the Federal Circuit in *Grain Processing Corporation v. American Maize-Products Company* case provides a further illustration and is, notably, a damages case rather than an accounting of profits. The plaintiff and defendant were the only significant suppliers of the product in question. When the defendant first entered the market its product was found to infringe. The defendant subsequently but unsuccessfully changed its process three times in an attempt, in part, to avoid infringing. Finally, a fourth process, which took only two weeks to perfect and begin to implement on a production scale, was then developed that did not infringe the patent. The evidence indicated that the only reason the fourth process had not been adopted previously was because the defendant believed each of the previous processes it had implemented also did not infringe.

The Court of Appeal upheld the District Court's decision that the fourth process could have been made available, and that it was an acceptable substitute for the claimed invention. It was irrelevant that the fourth process was not actually in existence at any time during the period of infringement because the evidence showed that the fourth process was easily and readily implemented, and that it would have been used by the defendants "but for" the findings of infringement.

1.1.3 Apportionment

In some cases it is plausible that the defendant's sales of the infringing items are not due entirely to the infringement, as, for example, when the defendant has made substantial improvements to the product. In such cases, it is established in the context of the accounting of profits that an apportionment of profits may be made when justified by the facts.²³ It appears that the same principle may be applied in the context of damages.²⁴ Where it is established that the defendant's efforts contributed to the sales but it is impractical to attribute any specific sales to that effort, apportionment may be appropriate.²⁵

However, as stated by Snider J. in *Jay-Lor v. Penta*, "apportionment is generally not available to limit the damages payable by the defendant."²⁶ The need for

²² *Grain Processing Corporation v. American Maize-Products Company* (1999), 185 F.3d 1341 at 1350-1351 (Fed. Cir.).

²³ See "Accounting of Profits in Intellectual Property Cases in Canada", *supra* note 15.

²⁴ *Jay-Lor*, *supra* note 8, at 190-99.

²⁵ *Jay-Lor*, *ibid.*, at 196, approving the possibility of apportionment, though not applying it on the facts.

²⁶ *Jay-Lor*, *ibid.*, at 123.

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apportionment will be infrequent if there is appropriate consideration of the next best non-infringing alternative. In essence, apportionment and consideration of the best non-infringing option serve the same purpose: limiting damages to the damage caused by the infringement.

If an apportionment is made, it is important to avoid double counting. If the estimate of lost sales excludes sales that were made on the basis of the defendant's contribution, either on the basis of an assessment of individual sales, or on a market share approach, it is not appropriate to further reduce the lost profits from sales that would have been made by the plaintiff. The onus is on the defendant to prove the basis for the apportionment.²⁷

1.1.4 Other Limits on Recovery: Remoteness and Foreseeability

Causation is not the only limit on recovery. Losses that are in fact caused by an infringement may nonetheless be unrecoverable if they are too remote. As the quotation from *Gerber v. Lectra* indicates, in modern tort law "remoteness" is not a test but a label for the conclusion that losses that satisfy the causation requirement should nonetheless be excluded. A conclusion that a loss is too remote is always based on some reason of "public or social policy"; a simple assertion that a loss is "too remote" is not usually accepted as persuasive.

The foreseeability requirement (a form of remoteness) is the best established limit on recovery in tort law apart from causation.²⁸ Generally, however, it plays little role in intellectual property cases, since it is only the nature of the loss, and not its extent, that needs to be foreseeable. Because the nature of the typical loss in intellectual property cases—lost sales or licensing revenues—is generally foreseeable,²⁹ the foreseeability requirement is usually easily satisfied.³⁰

In *Gerber v. Lectra*, the Patent Court and the English Court of Appeal extensively discussed remoteness in patent cases, holding that while remoteness does operate in intellectual property cases separately from questions of causation or foreseeability, it should not be based on an amorphous fear of "extending the monopoly of the patent":

Given that one can foresee these losses, why should the law not provide that the defendant must recompense the plaintiff? And all the more so where the defendant gets a corresponding benefit from his wrong. If that benefit were large enough it might pay the defendant to commit the wrong. ...

²⁷ *Jay-Lor, ibid.*

²⁸ As the Court of Appeal noted in *Gerber v. Lectra*, *supra* note 2, the foreseeability requirement is in principle a form of remoteness, but it is so well established that it is normally treated as an independent requirement rather than as a species of remoteness. Accordingly, for convenience we will use "remoteness" to mean remoteness issues other than foreseeability.

²⁹ John G. Fleming, *The Law of Torts*, 9th ed. (Sydney: Law Book Company, 1998), 240.

³⁰ However, remoteness may be a live issue with respect to more unusual damages claims: see the discussion "Losses of Subsidiary Companies" in section 2.6 below.

I think this is a very powerful policy reason for holding that these ancillary damages [springboard and convoyed sales damages] are recoverable. The supposed counter-argument is that articulated by Goff L.J.: that one is thereby setting up a wider monopoly than that provided by the patent. However, upon analysis one can see that this is not really so. The patentee has no monopoly in any of these matters. Anyone could have made peel-apart cameras or film, or sell service or parts, or sell post-expiry. There is no question of setting up a monopoly at all - there is only an investigation into the effect of the invasion of one.³¹

1.1.5 Mitigation

The principle underlying damages calculations applies in considering mitigation i.e. it is to put the plaintiff back into the same economic position it would have been in but for the infringement. Where the plaintiff has undertaken activities that it would not have undertaken in the "but for" scenario then the earnings that it has obtained as a result of those activities would be deducted from the damages otherwise calculated.

The cause of the company's ability to have undertaken those activities will depend on the circumstances but may include, for example:

- (i) The existence of manufacturing capacity that would otherwise not have been available had the plaintiff been manufacturing the product to which the infringement related;
- (ii) Diversion of marketing resources to alternative products with resultant increased sales which would not have occurred in the "but for" scenario; and
- (iii) The introduction of "follow on" or alternative products which, had the plaintiff continued with the infringed product, it would not have undertaken.

Mitigation strategies require an intimate understanding of the strengths, weaknesses and circumstances of the specific plaintiff as they were at the time of the loss.

Most of the considerations relevant to the determination of "but for" scenarios are relevant to the determination of appropriate mitigation strategies and the quantification thereof. The emphasis here is on "appropriate". Development of the "but for" scenarios and the mitigation scenarios each inform the other and no damage quantification is complete without addressing mitigation alternatives.

1.1.6 The Use of Hindsight

When determining the course of action that the plaintiff would have undertaken in the "but for" world, the use of hindsight is not permitted. Specifically, when considering whether the plaintiff would have manufactured and sold the product itself or licensed it, only the information available to the plaintiff at the commencement of the breach should be considered. The parties cannot argue for a

³¹ *Gerber Garment Technology v. Lectra Systems*, [1995] R.P.C. 383, at 400 (Pat. Ct.); largely aff'd supra note 2 (C.A.).

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course of action that hindsight shows would have been most advantageous, if all considerations known at the time pointed in another direction.

In such cases, the answer is properly inferred from the operating reality of the rights holder. Actual historical patterns or established strategy are important evidence, of course, but business plans, strategic plans, budgets, mission and vision statements, and the like must also be considered. With early-stage technology companies, one must rely much more on "what if" scenarios.

Though the construction of the "but for" position recognizes that the plaintiff would not have had benefit of hindsight in making decisions of the above described nature, in some cases, information based on hindsight may provide the court with the best evidence as to what course of action the plaintiff would have followed or information it would have known.³²

When determining the results under the "but for" scenario, use of hindsight is permitted. For example, if a licensing agreement would have been entered into but for the infringement, the royalty rate that would have been charged is based on a hypothetical negotiation carried out with only the information available to the parties at the time of the breach – without the use of hindsight. However, the sales on which the royalties are payable are the actual sales during the period of infringement – determined with the benefit of hindsight.³³

1.1.7 Taxation

Generally, an award of damages in intellectual property will be taxable to the recipient as normal business income³⁴ and payment of the damages award will be deductible to the defendant. However, it may happen that the nature of the award makes it a capital receipt and, hence, the amount will be subject to capital gains.

As a practical matter, we suspect punitive damages are also regularly deducted and taxed, respectively, by the defendant and the plaintiff. However, there is academic thinking to the contrary.

³² See *Jay-Lor*, *supra* note 8, at 154, in which Snider J. accepted the plaintiff / manufacturer's actual gross margin as the best evidence presented by the parties of what the defendant would have predicted its own manufacturing margin to be, in circumstances where the defendant did not have a manufacturing history of its own, and the plaintiff's actual gross margin is the one that the defendant could reasonably have calculated on a rough basis.

³³ In general tort law, see Major J.'s discussion in *Athey v. Leonati*, [1996] 3 S.C.R. 458, at 31-32 (under the heading "Independent Intervening Events"). Major J. cites the House of Lords in *Jobling v. Associated Dairies Ltd.*, [1981] 2 All E.R. 752 (H.L.). In *Jobling*, a plaintiff had suffered a back injury due to the negligence of the defendant. Damages were reduced because an unrelated spinal disease that developed after the injury would have proved totally disabling within a few years. Thus, hindsight was used to determine that the plaintiff would have become disabled even but for the accident. (On the facts in *Athey*, where the plaintiff's back was negligently injured in two traffic accidents by the defendants, and the plaintiff subsequently suffered a herniated disc during recovery, the Supreme Court ruled that there was no applicable independent intervening event.)

Consequently, damages are generally computed on a "pre-tax" basis – they are not reduced for income taxes.

1.1.8 The Value to Owner Principle

The "but for" damages concept often differs significantly from the concept of "fair market value" used in business valuation.

Fair market value is generally defined as the highest price available in an open and unrestricted market between informed, prudent parties acting at arm's length and under no compulsion to act, expressed in terms of money or money's worth. The key differentiator between fair market value and damages is that fair market value represents the price that would be negotiated between notional parties who are informed and acting prudently at arm's length. Damages however are unique to the specific plaintiff.

The notion of damages is akin to that of "value to owner", in which the particulars of the subject party are assessed. The relevant cash flows in a "but for" damages analysis are those which would otherwise have been earned by the specific plaintiff in the matter at hand, not some notional party in the marketplace. As a result, the relevant cash flows would be those which takes into account execution by the specific plaintiff, not a notional one, and the discount rate applied to those cash flows would be that which takes into account the specific execution risk of the plaintiff, not the execution risk of the market or a notional plaintiff.

This principle is not unique to intellectual property cases but applies to the general law of damages.

As earlier noted, with commodity style goods and more generic intellectual property, in some cases the fair market value of an asset is the same as its value to owner. Notwithstanding how important specific intellectual property might be to a specific plaintiff, if an equally effective alternative is readily available then the market price or fair market value of the alternative is the compelling measure of value in most cases in that it acts as a "ceiling" to the price that a prospective buyer would be willing to pay.

2.0 Lost Profits from Exploitation

A plaintiff is entitled to recovery of its lost profits. If the plaintiff would usually have exploited the invention by selling the product itself, the plaintiff can claim damages for lost sales.³⁵ Speaking broadly, lost profits are calculated as the foregone profit on the plaintiff's lost sales plus the diminished profit on the plaintiff's actual sales.

³⁴ See Canada Revenue Agency Income Tax Interpretation Bulletin IT-467R2.

³⁵ If the patent is a process patent, the plaintiff will generally be able to claim damages for lost sales of products made by the machine: see *Colonial Fastener Co. v. Lightning Fastener Co.*, [1937] S.C.R. 36, at 26-27.

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Generally heads of damage available to the plaintiff could comprise:

- (i) lost profits on sales that would have been captured by the plaintiff if the defendant had not infringed;
- (ii) lost profits on actual sales from price competition from the infringer;
- (iii) lost profits from higher production costs;
- (iv) lost profits from lost convoyed sales;
- (v) lost profits from deflated market entry ("springboard damages and early adopter advantages");
- (vi) losses of subsidiary companies;
- (vii) lost profits on substitute products; and
- (viii) lost potential (future) profits.

All of the above must have regard for the defendant's hypothesized behaviours, the possible existence of non-infringing alternatives available to the defendant and the ability of the plaintiff to have mitigated its losses as discussed previously.

2.1 Lost Profits on Lost Sales

2.1.1 Lost Sales

The burden is on the plaintiff to prove the number of sales that it would have captured but for the infringement.³⁶ A plaintiff may be compensated for lost sales both inside and outside Canada.³⁷ Usually, a plaintiff will prefer to receive an award of lost profits for lost sales rather than an award of a royalty for infringing sales, because a royalty typically splits the profit of the defendant between the plaintiff and the defendant.

The defendant is not an insurer against a general market crash, nor can the plaintiff complain of sales lost from legitimate competition. Changed external factors, such as an economic depression that reduces sales generally, entry of a new product in the market that would have reduced the plaintiff products market share or a rise in the price of raw materials that increases the plaintiff's production costs, must be taken into account in determining what the plaintiff's profits would have been but for the infringement. Conversely, if the market for the plaintiff's product is generally expanding, extrapolation of an increasing sales trend may be appropriate in determining what would have happened but for the infringement, subject to internal capacity constraints and other similar factors.

The fundamental question is, "What would in fact have happened but for the infringement?" This should be answered in a holistic fashion having regard to all

³⁶ See *Jay-Lor*, *supra* note 8, at 118.

³⁷ See *AlliedSignal Inc. v. DuPont Canada* (1998), 78 C.P.R. (3d) 129 at 139 (F.C.T.D.) and *Jay-Lor*, *ibid.*, at 178.

relevant factors, including both company-specific and macro-economic ones. These factors will offer opportunity for profit and present constraints and risk of loss. Where possible, the answer should be based on an economic model that captures the dynamic interplay of market forces as one might reasonably anticipate them to have played out over the relevant period with the benefit of hindsight.

These general principles imply that all factors that would have affected the plaintiff's profit should be taken into account in determining what profits the plaintiff would have made but for the infringement. In *AlliedSignal*, Heald D.J. enumerated a list of such factors that had been considered in prior Anglo-Canadian decisions:³⁸

- (i) the presence of competing products in the marketplace;
- (ii) the advantages of the patented products over competing products;³⁹
- (iii) the advantages of the infringing product over the patented product;⁴⁰
- (iv) the market position of the patentee;⁴¹
- (v) the market position of the infringer;⁴²
- (vi) the market share of the patentee before and after the infringing product entered the market;⁴³
- (vii) the size of the market both before and after the infringing product entered the market;⁴⁴ and
- (viii) the capacity of the patentee to produce additional products.⁴⁵

It is relatively straightforward to determine the level of market demand for the infringed products if the court has evidence of the infringing sales. The sales speak for themselves.⁴⁶ However, other items require much more detailed and careful market analysis. For example, showing that the plaintiff would have captured the defendant's sales requires proving that the intellectual property has market power, or that it could influence the market and draw sales to the item. This implies a detailed market analysis and provides an illustration of how factors unrelated to the infringement may affect damages. In *AlliedSignal*, Heald D.J. found that the patented product had significant advantages over the non-infringing alternatives. However, the

³⁸ *AlliedSignal*, *ibid.*, at 141.

³⁹ *United Horse-Shoe*, *supra* note 7, at 264; *Meters trial*, *supra* note 5, at 731.

⁴⁰ *Meters trial*, *ibid.*, at 731.

⁴¹ *Catnic Components*, *supra* note 6 and *Hamilton Cosco v. Featherweight Aluminum* (1965), 47 C.P.R. 40 (Ex. Ct. - Registrar). In the latter case it was found that the plaintiff, an American company, had an ineffective distributor in Canada (evidence was introduced that many large department stores in prominent cities had never heard of the distributor), so they would have only captured 20 percent of the defendant's sales, rather than 80 percent in the presence of a functioning distribution system.

⁴² *Meters trial*, *supra* note 5, at 731; *Catnic Components*, *supra* note 6, at 522.

⁴³ *Domco*, *supra* note 8, at 92 (F.C.T.D. - Prothonotary).

⁴⁴ *Domco*, *ibid.*, at 62 (F.C.T.D.).

⁴⁵ *Domco*, *ibid.*, at 92 (F.C.T.D. - Prothonotary); *Catnic Components*, *supra* note 6, at 522.

⁴⁶ Alternatively, market surveys can be used to show that customers would buy the product if it were available to them.

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infringing product had superior quality control compared with the plaintiff's product. Heald D.J. found that for at least one important customer the quality problems with the plaintiff's product were sufficiently serious that the evidence did not establish that but for the infringement, the plaintiff would have made the sales actually filled by the defendants. Consequently, the plaintiff was awarded a reasonable royalty rather than lost profits in respect of that customer.

This argument depends heavily upon the definition of the marketplace, including consideration of possible substitutes, classes of customers, demand and supply elasticities, and divisions by geography.⁴⁷ If the product in question is a widely distributed and purchased consumer product, it would generally be appropriate to look to market research, surveys and market share analysis. A market share analysis must take into account the full market realities, including for example, increased competition from other parties.⁴⁸ While market share analysis is an "inexact science", estimates based on a detailed assessment of factors relevant to the market in question and the particular plaintiff and defendant will be preferred over estimates based on more generalized considerations.⁴⁹ In contrast, if the infringing products are expensive, infrequently purchased items, it may be possible and appropriate to gather evidence on individual sales from specific customers.⁵⁰ The choice between these two methods of analysis depends on the facts of the case.⁵¹

The intellectual property owner must also demonstrate how it would satisfy market demand to capture these sales. Alternatives include in-house production with existing or expanded capacity, outsourcing, joint venturing and the like. The most appropriate basis will depend on the operating reality of the rights-holder. The quantum of lost profits is of course a function of the method by which demand is satisfied.

2.1.2 Lost Profits on Lost Sales

Having quantified the lost sales, and resulting revenues, the court needs to determine profits to assign to them, usually on a per item basis. To determine profit, cost must be determined. The appropriate costing methodology would depend on the fact circumstances may include elements of absorption and differential methods plus certain opportunity or economic related costs.⁵²

⁴⁷ This point is discussed in M.B. Stewart, "Calculating Economic Damages in Intellectual Property Disputes: The Role of Market Definition", (April 1995) JPTOS 321. At 334, Stewart writes:

Most antitrust issues cannot be analyzed in a meaningful way without consideration of the relevant market in which the act in question took place. Much the same can be said of damages in intellectual property disputes. Except for two polar cases — the "garage inventor" for whom lost profits are not in issue and the wronged (patent-holding) manufacturer or seller who could reasonably have expected to make all of an infringer's sales — the plaintiff in a patent dispute cannot be made whole without an explicit consideration of the relevant market(s) in which the patented product and the infringing product competed for sales.

⁴⁸ See *Jay-Lor*, *supra* note 8, at 212-214.

⁴⁹ See *Jay-Lor*, *ibid.*, at 215-216.

⁵⁰ This was the approach taken by Heald D.J. in *AlliedSignal*, *supra* note 37, where there were only nine infringing sales.

⁵¹ See *Jay-Lor*, *supra* note 8, in which Snider J. approved a market share approach but remarked at 208 that "[h]ad this case involved sales of only a few infringing products, more customer-specific evidence might have been required, as was the case in *AlliedSignal*."

The time over which the profits would have been earned, the circumstances of the plaintiff, physical sales volumes and capacity constraints — the operating reality of the plaintiff — will push one logically toward either the absorption or differential accounting approaches. They are not really alternatives in the computation of damages; there is an appropriate place for the application of each.

In *Domco*, Collier J. held as much, saying that the appropriate methodology depended on each case's "own particular facts and circumstances."⁵³ In the case at bar, he approved of Preston P.'s choice of the differential accounting method, citing the *Teledyne* case as precedent. Counsel for the defence had argued before the prothonotary that since all costs become variable in the long term, the application of differential costing was inappropriate for a 10-year period of infringement. Preston P. thought otherwise, and stated:

The differential accounting concept is explained in the text *Fundamentals of Management Accounting*, 3rd ed. by Anthony and Welsch where at p. 203 it states:

Differential costs always relate to the future; they are intended to show what the costs would be if a certain course of action were adopted, rather than what the costs were in some past period.

For the purposes of this reference am I not required to go back in time to 1967 and ascertain, on the basis of incremental sales lost by Domco due to the infringing activity of Armstrong, what incremental costs would have been incurred if such sales were in fact made by Domco?

If this is so then, as is expressed at p. 257 of the text: "differential costs are estimates of what costs will be in the future." However, I do not have to entirely estimate the incremental costs because I have the benefit of the use of historical costs available through Domco's and Armstrong's records.⁵⁴

As a general principle over the short term, the variable cost or differential costing method is appropriate. Where costs are truly fixed and would have been incurred by the plaintiff in any event, then it is likely inappropriate to deduct these costs for the damages award. In contrast, over the long term, the absorption method or full costing method may give the same results as the differential method as costs fixed in the short term become variable in the long term. Where capital expenditures need to be incurred to generate profits, they are an appropriate deduction.⁵⁵

⁵² These approaches are discussed further in "Accounting of Profits in Intellectual Property Cases in Canada", *supra* note 15. In differential costing, fixed costs are not deducted from revenues to determine profits; in absorption costing, some portion of fixed costs is deducted. Hence, the use of absorption costing decreases the quantum of profits.

⁵³ *Domco*, *supra* note 8, at 65 (F.C.T.D.).

⁵⁴ *Domco*, *ibid.*, at 89 (F.C.T.D.—Prothonotary). See also *Jay-Lor*, *supra* note 8, at 223 approving a differential cost approach on the facts of the case.

⁵⁵ See "Accounting of Profits in Intellectual Property Cases in Canada", *supra* note 15 for further discussion of this issue.

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The applicability of certain opportunity or economic related costs will depend on the facts; there is no general rule. Note that it is possible to construct a damages equivalent to the differential profits argument in the accounting of profits context.

If, due to the infringement, the plaintiff put his assets to an alternative profitable use, then a strict interpretation of the principle of restoration might suggest that a portion of these profits should also be subtracted from the lost profits to arrive at an amount that will restore the plaintiff to where it would be but for the infringement.⁵⁶

Presumably, the basis for this argument would be proof that the plaintiff had in fact enjoyed this "opportunity benefit" which it would not otherwise have enjoyed.

However, there is no example of this explicit argument in the surveyed intellectual property case law or literature. It bleeds into the impact of mitigation.

2.2 Lost Profits due to Price Reductions

A plaintiff can also claim damages from price reductions forced by competition from the infringer.⁵⁷ Such a price reduction may be considered to be caused by the infringement, notwithstanding that the direct cause of the price reduction was the plaintiff's decision. There is case law to the effect that, for this head of damage to be sustained, the plaintiff's price reduction must have been reasonable in the circumstances,⁵⁸ must have been in response to the defendant's lower price, and must not lower the plaintiff's price below that of the defendant.⁵⁹ However, these cases followed the "natural and direct" remoteness test that has been supplanted in modern tort law. In the absence of more recent case law, detailed discussion of this point is difficult. It can be said that losses from price reductions are not generally too remote, though in particular instances they may be.⁶⁰

It appears that there is no decided Commonwealth case where it was successfully alleged that the effect of the competition was only to prevent the plaintiff from making price increases. This argument was accepted as a possible ground of damages by both parties in the *AlliedSignal* reference, but Heald D.J. did not rule on the issue because there was insufficient evidence.⁶¹ Similarly, this head of damages was accepted as a possibility in the South African Court of Appeal, but again failed

⁵⁶ If, due to the infringement, the plaintiff has available to it assets that it is able to put to an alternative profitable use, a strict interpretation of the principle of restoration might suggest that the profit actually earned through the alternative use should be subtracted from the lost profits to arrive at an award that will restore the plaintiff to where it would have been absent the infringement.

⁵⁷ See *Colonial Fastener*, *supra* note 35 and *American Braided Wire Co. v. Thompson & Co.* (1890), 7 R.P.C. 152 (Eng. C.A.).

⁵⁸ See *United Horse-Shoe*, *supra* note 7.

⁵⁹ *Colonial Fastener*, *supra* note 35, at 30 (S.C.C.).

⁶⁰ For example, in *Colonial Fastener*, *ibid.*, the Supreme Court rejected a claim for losses from a price reduction that the plaintiff asserted was made because its sales representatives had been told, apparently falsely, by prospective or actual customers that they would otherwise purchase more cheaply from the defendants. The court held that these losses were too remote (at 49). However, the court's treatment of the issue was cursory, and it may have been that the court was simply not satisfied on the facts that the price reduction had been induced by the threat of infringing competition, rather than by the threat of general competition.

⁶¹ See *AlliedSignal*, *supra* note 37, at 181.

for lack of evidence.⁶² However, American courts have awarded damages for such price erosion where sufficient proof of the effect has been offered.⁶³

As narrowly interpreted in the existing case law, this head of damages rests on evidence of the timing of the price reductions compared with the price in the market. A court may reduce the award from what it otherwise would have been if it thinks that the plaintiff's reduction in price led to an increase in the size of the market,⁶⁴ essentially taking into account the plaintiff's mitigation efforts. Holding the market size constant, if the reduction was only partly due to the infringing acts of the defendants, an award may be made with respect to the part of the loss that results from such reduction.⁶⁵ The lost profit from a justified lower price may be claimed for both the sales the plaintiff actually made and the sales it would have made but for the infringement.

2.3 Lost Profits due to Increased Costs

Lower volumes resulting from the defendant's infringement can mean the same costs (often fixed costs) need to be allocated over fewer units resulting in a higher cost per unit on a full cost basis. Sometimes absolute costs are higher due to a loss of purchasing discounts or volume rebates. Both of these types of higher costs are often called a "loss of economies of scale". Manufacturing economies of scale can include:

- (i) lower bulk purchasing prices from suppliers;
- (ii) lower labour and material cost due to better utilization when manufacturing at higher batch sizes;
- (iii) the costs of start-up and shut-down if the manufacturing facility is sometimes idled due to lower production volumes; and
- (iv) higher error rates and therefore higher costs per run.

Other expenses may increase absolutely or relatively to meet the competition from the infringer and can be included in a damage claim. These include heavier advertising expenses, adding sales personnel, the increased use of discounts, or investing more heavily in a distribution system to improve service.

An award for increased expenses was allowed in *Jay-Lor* where Snider J. noted that "[t]here is a causal connection between the incurring of the additional selling

⁶² *Omega Africa Plastics Pty. Ltd. v. Swisstool Mfg. Co. (pty.)*, [1978(3)] S.A. 465, at 475 (App. Div.), as quoted in *AlliedSignal, ibid.*, at 201.

⁶³ See *Minnesota Mining and Manufacturing v. Johnson & Johnson Orthopaedics*, 976 F. 2d 1559; 24 U.S.P.Q. 2d 1801 (N.D. Ill. 1993); aff'd 71 F. 3d 1573, 37 U.S.P.Q. 2d 1138 (Fed. Cir. 1995). Compensable price reductions include reduction on the announcement of the introduction of a competing product; see *Brooktree v. Advanced Micro Devices Inc.*, 977 F. 2d 1555, at 1578-1581, 24 U.S.P.Q. 2d 1401, at 1417-1419 (Fed. Cir. 1992).

⁶⁴ See *American Braided Wire Co.*, *supra* note 57.

⁶⁵ See *Colonial Fastener*, *supra* note 35.

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expenses and [the defendant's] entry into the market. For this reason, I am inclined to agree . . . that an accounting should be done to reflect these costs."⁶⁶

Similarly, an award for increased expenses occurred in the *Domco* case for financing costs, where Preston P. allowed \$228,000 in additional damages:

Had Domco earned more profit in the period in question as a result of additional sales, its working capital from operations would have been correspondingly increased thereby effecting a corresponding reduction in its debt load. This would have reduced the cost of borrowed money.⁶⁷

2.4 Lost Profits from Lost Conveyed Sales

Conveyed sales are sales of goods that are typically sold with or as a result of the sale of an allegedly infringing item though the goods themselves are not protected by the intellectual property in question. The issue is particularly important in industries where a patented product is sold at a modest price, with most of the profit being generated by a service contract or sale of supplies.⁶⁸ To the extent that the loss of conveyed sales flows from the loss of the sales of the patented product then it is appropriate to quantify and claim both amounts.

Consistent with *Gerber v. Lectra*,⁶⁹ in *Jay-Lor*, the defendants argued that certain components, namely conveyers, were separate add-ons and not part of the infringing product, the vertical feed mixer. Snider J. found that Jay-Lor would not have sold a vertical feed mixer without a conveyor, and therefore concluded that Jay-Lor's damages included the loss of the sale of conveyors.⁷⁰

2.5 Springboard Damages and Loss of Early-Adopter Advantages

A patentee or other intellectual property holder may enjoy residual advantages even after the formal term of protection is over. After expiry of a patent, competitors are entitled to enter the market, but it will take time for them to build up a customer base and start taking a share of the previously protected market. Infringement allows a competitor a head start in gaining market share; a competitor who infringed prior to the expiry will have a larger market share on expiry than one who started competing only the day the patent expired. Conversely, the patentee will have a smaller market share in the period just subsequent to expiry than it would have had in the absence of infringement.

⁶⁶ *Jay-Lor*, *supra* note 8, at 248.

⁶⁷ *Domco*, *supra* note 8, at 94 (F.C.T.D.—Prothonotary). Preston P. was adopting statements from the affidavit of an expert witness.

⁶⁸ The classic example is ink-jet printers, where printers are sold at reduced prices in the expectation of substantial profits on the sale in ink-jet cartridges.

⁶⁹ *Gerber*, *supra* note 31.

⁷⁰ *Jay-Lor*, *supra* note 8, at 198.

Successful technology companies have demonstrated the importance of being an early entrant into a market and capturing market share. Convincing customers to be early adopters of their technology often ensures continued customer loyalty. Once technology is imbedded in a customer's operations or product, it is difficult and expensive to dislodge. Customers who have successfully integrated a particular software technology are generally, subsequent to adoption, a recurring source of service, upgrade and consulting revenues. A plaintiff that has been denied early market entry and customers' early adoption of its technology will have lost the broad base of benefits thereof.

The quantum of this residual advantage to the infringer is a function of the market share wrongly taken, the duration of the advantage, the infringer's profitability, the plaintiff's market response, and other factors. The plaintiff's loss is a function of the plaintiff's unique responses to the infringer's actions. The compensable damages are the result of dynamic factors—internal and external to the plaintiff. Damages of this nature are known by various descriptive terms: "springboard," "head start," "early-adopter," "bridgehead" or "accelerated entry" damages.

The view that such losses should be compensable in damages is consistent with the principle that, subject to consideration of non-infringing alternatives, the plaintiff is presumably entitled to all losses caused in fact by the infringement.

2.6 Losses of Subsidiary Companies

The English Court of Appeal in *Gerber*, following the *George Fischer* case,⁷¹ unanimously held that the parent of a subsidiary can recover damages in respect of losses at the subsidiary company even if the subsidiary has no cause of action against the defendant. However, the court split on the standards of proof needed to support such a claim. Hobhouse L.J. and Hutchison L.J. both held that the plaintiff needed to explicitly prove the quantum of damage to the subsidiary that would flow through to the parent company. On the facts of the case, they held that *Gerber* had failed to address the impact of taxes, the subsidiaries and parents being located in different countries with different currencies, transfer pricing, and a complicated corporate structure, and denied *Gerber*'s claim. In contrast, Staughton L.J. held that this approach would lead to injustice because plaintiffs would generally find it impossible to meet such standards of proof. Instead, he supported the approach of Jacob J. at trial, finding that there was a rebuttable presumption that a dollar lost by a wholly owned subsidiary is equal to a dollar lost by the parent.⁷² In the Canadian case of *Domco*, the successful plaintiff was in a similar position in respect of its Canadian subsidiaries. Consistent with the approach taken by Staughton L.J. in *Gerber*, Preston P. allowed *Domco* to claim \$625,000 for damages suffered by the subsidiaries. However, Collier J. disallowed this award on appeal, stating:

⁷¹ *Gerber*, *supra* note 2, at 456, 478, and 481; *George Fischer (Great Britain) Ltd. v. Multi Construction Ltd.* [1995] 1 B.C.L.C. 260 (Eng. C.A.).

⁷² *Gerber*, *ibid.*, at 457. Staughton L.J. did hold that the effect of taxes was not adequately addressed by Jacob J., and would have remitted this issue to Jacob J. for further consideration.

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The damages are only recoverable by the legal entities who incurred them. Further, the contention that Domco would have been paid increased dividends, or enlarged its equity, is too speculative, if not too remote. The subsidiaries could have applied the "lost" profits in many ways, purely for their own advancement or benefit.⁷³

2.7 Lost Profits on Substitute Products

If the patentee was not selling the patented product, but was instead selling a substitute product, it appears that the patentee may claim for the lost profits on the substitute product, so long as it can establish that lost sales of the substitute product was the consequence of competition from the infringer.⁷⁴ Conceptually, this is consistent with the loss of profit on convoyed sales and with the broader concept of simply making the plaintiff whole.

2.8 Lost Post-Trial Profits – Future Losses

In principle, damages encompass a loss of future profits on sales that, but for the infringement, would have been made after the date of the trial. Where there are lost profits after a date of trial that are clearly attributable to an infringement, they are best computed by application of a discounted cash flow technique. Care needs to be taken in this exercise because the projection entails the interaction of many variables.

The discount rate must be carefully chosen to reflect only the relevant execution and market risks. The discount rate will very much depend on the quality of the financial inputs. Where there are clearly lost future profits but they cannot be specifically traced to identifiable sales, or specific assets, tangible or intangible, the lost future profits are often characterized or quantified under the nomenclature of "goodwill".

In principle, lost goodwill attributable to the infringement should also be compensable in the same manner as lost future profits from identifiable assets. Again, discounted cash flow techniques are usually the best tool for computing the value of lost goodwill.⁷⁵

3.0 Reasonable Royalties

Reasonable royalty calculations are generally made in four contexts:

- (i) where the plaintiff typically exploits its intellectual property through licensing;
- (ii) where the plaintiff exploits its intellectual property directly, but the defendant has made sales that would not have been captured by the plaintiff in any case;

⁷³ *Domco*, *supra* note 8, at 69.

⁷⁴ See *Eli Lilly Co. v. Apotex, Inc.*, 2009 FC 991, 80 C.P.R. (4th) 1, at 651 and 863. The point was not decided as the patentee was permitted to elect an accounting of profits.

⁷⁵ For a general discussion of future or post-trial damages, see *Athey*, *supra* note 33, at 26-30.

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- (iii) where the defendant has made sales into a market that was not or could not be accessed by the plaintiff;⁷⁶ and
 - (iv) where the plaintiff has failed to prove either a "habitual" licensing fee or lost profits.

In addition, in *Jay-Lor*, Snider J. held that in the laid open or pre-grant period a patentee is not entitled to claim its lost profits as "reasonable compensation". Instead she equated the term "reasonable compensation" to "reasonable royalty" as understood in the context of post-grant damages.

The method for determining reasonable royalties has been given several formulations in different cases.

Whether damages are being calculated for infringing sales that a patentee plaintiff could not prove it would have captured, or for lost licensing revenue, there are three methods by which one can determine a reasonable royalty.

- (i) Where it is typical of the plaintiff to exploit its intellectual property through licensing often providing an established history of negotiated licences for products comparable to the one that has been infringed, a straightforward application of historical licence rates to determine reasonable royalties is preferred.
- (ii) Further, an indication of reasonable royalties may be found by examining comparable licences within a given industry.
- (iii) In the absence of or in addition to historical or industry-wide "normal" royalty rates, the next best approach to determine a reasonable royalty is to construct a hypothetical negotiation and assess various factors to determine the appropriate amount of a hypothetical licensee's (that is, an infringer's) anticipated profits that should be paid to the licensor (that is, the plaintiff) as a result of the infringement.

⁷⁶ In such cases in which, put loosely, the defendant's use "has not hurt" the plaintiff, the plaintiff is entitled to a reasonable royalty, ultimately for the pragmatic reason that, "[o]therwise, that property which consists in the monopoly of the patented articles granted to the patentee has been invaded, and indeed abstracted, and the law, when appealed to would be standing by and allowing the invader or abstractor to go free". See *Watson Laidlaw Co. Ltd. v. Pott, Cassells and Williamson*, (1914), 31 R.P.C. 104, at 120, per Lord Shaw. To the same effect, see *Meters appeal*, *supra* note 5, at 164-65, per Moulton L.J.

3.1 Established Licences and Normal Royalty Rates

Strong evidence of the market rate for a licence exists if the plaintiff has an established history of negotiating licences for product comparable to the one that has been infringed. The most straightforward application of historical licences occurs when the patentee routinely granted licences at a certain rate. This, however, is rarely the case, as the criteria for an "established" royalty" are as follows:

- (i) they must be paid or secured before the infringement began;
- (ii) they must be paid by a sufficient number of persons to indicate the reasonableness of the rate;
- (iii) they must be uniform in amount;
- (iv) they must not have been paid under threat of suit or in settlement of litigation; and
- (v) they must be for comparable rights or activities under the patent.⁷⁷

However, it must be emphasized that there is no rule that whenever the rights holder has granted a licence in the past, it is limited to an award of reasonable royalties. The question is whether the historical patterns of licensing establish that the plaintiff would have granted a licence to the defendant on the established terms if it had been approached at the time of the infringement. A pattern of granting licences is good evidence that the rights holder would have granted a licence if the defendant had approached it; an occasional grant of a licence in special circumstances is not.

Note also that a normal rate can only be taken as evidence of the rate the plaintiff would have agreed to if the defendant's use fell within the normal terms of the licence. When the defendant's use would have been a breach of standard licence terms, it is unreasonable to suppose that the plaintiff would have agreed to license such a use at the standard rate.⁷⁸

Licences negotiated to settle litigation have been held by the House of Lords not to be indicative of the "going rate"⁷⁹ because such rates are not embracing of all the dynamics that would have been in play at the time of the infringement. An example of this occurred in the case of *Consolboard v. MacMillan Bloedel*.⁸⁰ The court had evidence of three alternative negotiated royalties: first, an agreement to pay a royalty of 2.5 percent of the net factory selling price; second, a royalty of 3.5 percent; and third, a licence for 4.5 percent. The first licence was negotiated with the former employer of the inventor, who had a strong claim to "shop rights" in the invention, while the third amount was negotiated partly to avoid litigation over the validity of the

⁷⁷ See *Mobile Oil Corp. v. Amoco Chems. Corp.*, 915 F. Supp. 1333, 1342 (D. Del. 1994). The *Mobil* case notes that "[b]ecause of these stringent criteria, few courts have actually found and established royalty."

⁷⁸ See *Monsanto Co. v. McFarling*, 488 F. 3d 973, 979 (Fed. Cir. (2007)).

⁷⁹ *General Tire & Rubber Co. v. International Synthetic Rubber Co. Ltd.*, [1968] R.P.C. 161.

⁸⁰ *Consolboard Inc. v. MacMillan Bloedel (Sask.) Ltd.* (1982), 63 C.P.R. (2d) 1 (F.C.T.D.), varied (1983), 74 C.P.R. (2d) 199 (F.C.A.).

patents in question.⁸¹ In both cases, the negotiated rates would reflect these particular circumstances, and the court rejected these royalties as not reflecting an agreement between a willing licensee and licensor bargaining on equal terms. This was upheld by the Federal Court of Appeal.

3.2 Industry Standard Rates

An indication of reasonable royalties may be found by examining comparable licences within a given industry. As it is unlikely that an exactly comparable licence can be found, this approach requires the evaluator to adjust for the exact context of the hypothetical licence.

The fundamental criticism of comparison to existing licences is that the approach ignores the actual profitability of the intellectual properties and companies in question. Nevertheless, industry standard rates quite often are similar to royalty rates found through financially based methods, and can often form a valuable benchmark for review.

However, in looking into industry-standard rates, it is essential to establish that the "standard" rates reflect market conditions that are comparable to those that would have been faced by the plaintiff and defendant at the relevant time. If this cannot be established, the industry-standard rates will be of little assistance, and "one should prefer the results that are based on the application of a generally accepted methodology to the specific facts of the case at hand."⁸²

3.3 The Hypothetical Negotiated Licence

There is no difference in principle between a normal royalty and a reasonable or hypothetical negotiated royalty. The difference is in the evidence relevant to establishing the royalty. When it can be established that the plaintiff habitually granted licences at a normal rate, then this normal rate is the best evidence of the rate that that plaintiff would have agreed to, and there is no need to inquire as to idiosyncratic aspects of the business position of the two parties. When a normal rate cannot be established, then more detailed evidence is required to establish the outcome of the negotiation that would have taken place but for the infringement.

⁸¹ Shop rights in the United States exist when an employee who is not employed for the purpose of invention invents and develops an invention; which the plant puts into use as part of the development process. In such cases, the plant has a "shop right" to continue using the invention without payment to the patent-holder. The plant, however, cannot sell the patented item or build copies.

⁸² See *Jay-Lor*, *supra* note 8, at 129.

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If the evidence does not establish a historical normal rate to apply, then damages will be based on the reasonable royalty that would have been agreed to by a willing licensee and licensor if they had negotiated a licence at the time of first infringement.⁸³ This hypothetical negotiation is also the approach taken in the United States.⁸⁴

It is possible that, in some cases, the price at which the right-holder acting reasonably would have licensed his intellectual property is higher than the maximum price that the infringer would have been willing, or perhaps able to pay. The treatment of this situation depends on the remedial theory being applied; generally however, the principle of compensation and the "but for" test implies that the court should act to restore the licensor to where it would have been but for the infringement, not to where the licensor would have been if it had licensed the infringer.

In a hypothetical negotiation, a reasonable royalty rate is "that which the infringer would have had to pay if, instead of infringing the patents, [the infringer] had come to be licensed under the patent."⁸⁵ Or, as was said by Falconer J. in the reference in *Catnic Components*:

I have to consider "what would have been the price which...could have reasonably been charged" for the plaintiff's permission to use the patented invention as the defendants did. In his opinion in the *General Tire* case Lord Salmon thought ... that in a case where there is no established market rate the assessment must be based on the basis of what royalty a willing licensee would have been prepared to pay and a willing licensor to accept.⁸⁶

This implies that the parties are acting reasonably and are under no compulsion to license.⁸⁷ Extrapolating from the definition of fair market value, a fair market royalty might be defined as the "highest royalty in an open unrestricted market between informed and prudent parties acting at arm's length under no compulsion to license, expressed in terms of money or money's worth". The fair market royalty is generally expressed as a rate, requiring that the base against which it is applied be clear.

⁸³ See *AlliedSignal*, *supra* note 37, at 176; *Catnic*, *supra* note 6, at 530, per Falconer J.: "where there is no established market rate the assessment must be on the basis of what royalty a willing licensee would have been prepared to pay and a willing licensor accept."

⁸⁴ For a good summary of U.S. law on this point, see *Applied Med. Res. Corp. v. United States Surgical Corp.*, 435 F.3d 1356 (Fed. Cir. 2006).

⁸⁵ *AlliedSignal*, *supra* note 37 at 176, and *A.G. for Autogene Aluminium Schweissung v. London Aluminium Co. (No. 2)* (1923), 40 R.P.C. 107 at 113 (Ch. D.). Similarly, in *Colonial Fastener Co. v. Lightning Fastener Co.*, [1936] 2 D.L.R. 194 at 205 (Can. Ex. Ct. - Referee), Duclos referee said: "I find that as to such sales the defendants are liable to pay a fair royalty, that is, they must pay the plaintiff what it would have cost them to make these sales lawfully." This decision was upheld upon appeal to the Supreme Court of Canada.

⁸⁶ See *Catnic*, *supra* note 6, at 530. See also Sargent J. in *Autogene Aluminium Schweissung*, *ibid.*, at 113.

⁸⁷ Similarly, in the United States the Sixth Circuit court stated the "willing licensor-willing licensee" rule to determine reasonable royalties: In fixing damages on a royalty basis against an infringer, the sum allowed should be reasonable and that which would be accepted by a prudent licensee who wishes to obtain a licence but was not so compelled and prudent patentee, who wished to grant a licence but was not so compelled. In other words, the sum allowed should be that amount which a person desiring to use a patented machine and sell its product at a reasonable profit would be willing to pay. *Horvath v. McCord Radiator & Manufacturing Co.* 100 F.2d 326 (6th Cir. Mich. 1938).

The notional date at which the royalty rate would be struck, is immediately prior to the date of the first infringement. This can be a factor in the licensing of risky technology, because the licensee might obtain favourable terms for bearing substantial risk.⁸⁹ The balance of risks and benefits is somewhat offset by the "book of wisdom" principle allowing consideration of events after the hypothetical negotiation, but before trial. ("At times the only evidence available may be that supplied by testimony of experts as to the state of the art, the character of improvement, and the probable increase of efficiency or saving of expense. This will generally be the case if the trial follows quickly after the issue of the patent. But a different situation is presented if years have gone by before the evidence is offered. Experience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect. We find no rule of law that sets a clasp upon its pages, and forbids us to look within.")⁹⁰

A "hypothetical negotiation" is not thought of as occurring between parties in isolation. Instead, it is presumed to take place in an open and unrestricted market where all prospective licensees will notionally participate and all relevant factors in the marketplace would be considered. The presence of non-infringing alternatives to the use of the intellectual property available to the licensee must be considered and they will tend to limit the amount that a licensee would be willing to pay for the intellectual property.⁹¹ This is illustrated in *Grain Processing*⁹¹ where the non-infringing alternative available to the defendant was found to cost slightly more than the infringing alternative and the court found that this production cost difference effectively capped the reasonable royalty award.

Balancing the licensee's ceiling is the licensor's floor, or royalty below which a licensor would have been unwilling to agree. That floor would notionally be established by considering all the avenues of exploitation reasonably available to the licensor and the related risk/reward ratio, having regard for the licensor's then operating realities.

⁸⁹ For example, in *Integra Lifesciences I Ltd. v. Merck KGaA*, 331 F. 3d 860 (Fed. Cir. 2003); rev'd, 545 U.S. 193, 125 S. Ct. 2372 (2005), the defendant conducted initial work on the plaintiff's pioneer technology while licensing negotiations were ongoing. Negotiations broke down and litigation ensued. The damages awarded at trial were relatively low because the hypothetical bargain was held to have taken place early in the process, before the defendant's work crossed the line from pure experiment to development. Because the technology was still very risky at that time, the court held that the plaintiff would have agreed to terms very favourable to the defendant. Indeed, it appears that in order to obtain a better hypothetical bargain, the plaintiff was arguing the experimental-use defence on behalf of the defendant in order to push the date of the hypothetical bargain downstream, where the technology had shown increased promise. See also *Boston Sci. Corp v. Cordis Corp.* 777 F. Supp. 2d 738, 791 (D. Del. 2011), citing *Georgia-Pacific*, *infra* note 92 and *Wang Labs, Inc. v. Toshiba Corp.*, 993 F. 2d 858, 869 (Fed. Cir. 1993).

⁹⁰ See *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 298 (U.S. 1933).

⁹¹ See Shifley, C., "Alternatives to Patent Licenses: Real-World Considerations of Potential Licensees Are — and Should Be — A Part of the Courts' Determinations of Reasonable Royalty Patent Damages", (1993) 34 IDEA 1.

⁹² See *Grain Processing*, *supra* note 22.

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Suppose, for example, that a licensor is faced with two potential licensees in the same market – one is an efficient corporation and the other is inefficient. Assume that the efficient licensee is thus able to generate larger excess profits through use of the intellectual property than the inefficient potential licensee. If both potential licensees are equally able to enter relevant markets, the more efficient firm will be a more attractive licensee than the less efficient firm, and the royalty negotiated with the efficient licensee will likely be higher than that which would be negotiated with the inefficient licensee in isolation. Although the less efficient firm may well be able to negotiate a licence from the rights holder, the royalty it ought to pay will be increased by the presence of the more efficient firm.⁹²

Licence terms historically agreed to by the plaintiff may be relevant even if the circumstances are sufficiently different that they cannot be taken as establishing a normal royalty.⁹³ The difference is simply in adjusting for these differences where possible.

3.3.1 The Royalty Base

Before one determines the royalty rate, it is necessary to understand the base to which that royalty rate will be applied as this necessarily influences the rate.

This factor has not received great attention in the Canadian case law but, generally, the base is sales. However, it is not necessarily definitive as to what sales are the relevant sales.

Another consideration is that it may be difficult for the licensor to verify the actual level of use of the technology by the licensee, or the technology may also create irregular but significant convoyed sales. In such cases, the licensor may prefer that the royalty be at least partially based on verifiable sales of products that do not incorporate the licensed technology.

In the United States, the "entire market value rule" is sometimes used to determine the royalty base. If the patented component is the "basis for customer demand," then the revenue from the entire product may be used in the royalty base.⁹⁴ However, this rule has been heavily criticized as overly rigid, and may lead to unrealistic results.⁹⁵ For example, in the recent *Uniloc v. Microsoft* decision,⁹⁶ Uniloc's expert used the entire market value rule to justify a reasonable royalty of 2.9 percent of the gross

⁹² United States law also reflects the state of the overall market. Chisum §20.03[3] states: "The more recent decisions stress the limited utility of the willing buyer-settler rule." See *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970); mod'd. and aff'd. 496 F.2d 295 (2d Cir. 1971) and *Panduit Corp. v. Stahl Brothers Fiber Works, Inc.* 575 F.2d 1152, at 1156 (6th Cir. 1978).

⁹³ Of course, previous licensing arrangements are still valuable evidence in finding this hypothetical royalty. Chisum notes that in the United States, existing licences provide, as a practical matter, a floor beneath which the judicially ascertained reasonable royalty is unlikely to fall. Chisum, *ibid.*, at §20.03.

⁹⁴ The seminal case is *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, at 1545, 35 U.S.P.Q.2d 1065 (Fed. Cir. 1995) (en banc).

⁹⁵ See U.S. Federal Trade Commission, "The Evolving IP Marketplace," *supra* note 10 at 205-212 for a discussion and critique.

⁹⁶ *Uniloc USA, Inc. v. Microsoft Corp.*, *infra* note 126.

revenue for all of Microsoft's products that contained product keys for activation; in contrast, the plaintiffs did not show that the activation feature was the basis for customer demand. The Federal Circuit overturned this result and cautioned against using the entire market value rule where the patented component does not create the basis for customer demand.

It appears that this is the same principle that applies in the context of apportionment in accounting of profits or damages for lost profits whereby the defendant's sales of the infringing items are not due entirely to the infringement. Care must be taken, however, to avoid double counting. If the royalty base excludes sales that were made on the basis of the defendant's contribution, either on the basis of an assessment of individual sales, or on a market share approach, it is not appropriate to further reduce the reasonable royalty by way of apportionment.

3.3.2 Apportionment

Damages in the form of lost profits may be apportioned if the defendant's contribution accounted for a significant portion of the demand. Historically, the issue of apportionment does not appear to have arisen directly in the context of damages in the form of a reasonable royalty and generally apportionment has not been considered in this context in Canadian cases.

Improvements made by the defendant should be considered in setting the royalty rate. As a result, it should not usually be necessary to perform an apportionment. However, it would be consistent with the context of damages for lost profits if damages in the form of reasonable royalty may be apportioned if, for example, improvements made by the defendant account for a significant portion of the demand.⁹⁷ It would also be consistent with the Federal Circuit's findings on the entire market rule in the *Uniloc* case, which warned that admitting accused product revenues can be the basis for a new trial on damages if the accused technology is not the basis for customer demand. Again, the onus is on the defendant to prove that demand for the product arose from circumstances other than the patented features.⁹⁸

3.3.3 The Royalty Rate

Having determined the royalty base, it is then necessary to determine the royalty rate to apply to that base. There are three approaches one can apply:

- (i) The Anticipated Profits Approach;
- (ii) The Analytical Approach; and
- (iii) Investment Return Analysis.

⁹⁷ *Jay-Lor*, *supra* note 8, at 190-99.

⁹⁸ *Jay-Lor*, *ibid.*, at 196.

Each of these approaches is discussed below. While these approaches contemplate a running royalty, not all royalties take the form of running royalties. Other forms of royalties include lump sum, per unit, and sliding scale.

3.3.3.1 *The Anticipated Profits Approach*

An insightful and commonly used framework for thinking about the split of estimated profits between the hypothetical licensee and licensor is the anticipated profits approach. This approach has been a long-standing approach in the licensing industry and seeks to share the profits in a fair manner so that each party could expect to benefit from the relationship proportionately to its investment and level of risk. The two Canadian trial decisions that have analyzed a reasonable royalty in detail, *AlliedSignal* and *Jay-Lor* have both applied the anticipated profits approach. In the ten years between the *AlliedSignal* and *Jay-Lor* decisions, there has been considerable development in the method adopted by the courts to determine a reasonable royalty rate, culminating in the adoption of the anticipated profits approach in *Jay-Lor*.⁹⁹ In *AlliedSignal*, this was labeled the "25 percent rule", but "anticipated profits" is arguably a more accurate description.

The anticipated profits approach refers to the profits of the defendant licensee and not the plaintiff licensor. *AlliedSignal* used a variant of this rule wherein Heald J. took the profits the plaintiff would have made had it hypothetically entered the market and made the infringing sales.¹⁰⁰ This is referred to in the *Jay-Lor* case as the *AlliedSignal* approach.

The general rule should be to look to the licensee's profits first.¹⁰¹ The intent is that a reasonable royalty will share the anticipated profits earned by the licensee from exploitation of the intellectual property between the parties, with the larger part typically going to the one who bears the most risk – usually the licensee.

There are numerous methods to decide how to divide the profit flow between licensee and licensor, and we will examine three: the anticipated profits approach, the analytical approach, and investment return analysis. The three alternative methodologies are all ways of approaching the ultimate legal question of what would have happened had the parties negotiated a licence. They should provide roughly consistent and reconcilable results, and the choice between them will depend on the evidence. In some cases there may be evidence that a particular methodology is commonly used in a particular industry. In other cases one or more of the methodologies may be applicable in principle, but not useful because the factual basis for applying it is not available on the evidence.¹⁰²

⁹⁹ See M. Crichton, *Canada Adopts the Anticipated Profits Approach for Calculating a Reasonable Royalty Rate* (2008).

¹⁰⁰ *AlliedSignal*, *supra* note 37, at 212.

¹⁰¹ See *Jay-Lor*, *supra* note 8, at 147, in which Snider J. rejected the *AlliedSignal* approach on the evidence before her, while recognizing that it might be applicable in other situations.

¹⁰² See *Jay-Lor*, *ibid.*, at 139, where the plaintiff's expert noted that that data on the defendant's financial situation and business model, which was necessary to apply the analytical approach, was not available.

The usual starting point in this analysis is an estimation of the anticipated economic benefit of the intellectual property in the hands of a licensee.¹⁰³ The absorption cost approach is used to deduct both direct variable and incremental overhead costs from the infringer's net sales.¹⁰⁴ In contrast to the analytical approach discussed below, the focus is on the licensee's expected incremental profits on a full absorption basis from the use of the protected technology, not its historical profits.¹⁰⁵

The hypothetical negotiation will divide these anticipated profits between the licensor and the licensee so that the profits are shared based on:

- (i) their relative contribution of assets; and
- (ii) risks faced by each party.

There exists an assumption that the licensee should be entitled to the larger part of the pre-tax profits which is based on an assumption that the licensee is taking on a large risk element and contributing substantial assets to the venture. The contribution and risks, and precise share will be a matter of evidence.

The greater or lesser the risks undertaken by the licensee, the higher or lower the licensee's proportion of the pre-tax profit, respectively. In particular, if exploiting the licence requires an investment by the licensee in complementary assets (such as manufacturing and distribution capability), the risk to the licensee is correspondingly higher than it would be if the licensee is able to use pre-existing assets. Risk is also a function of the alternative opportunities available. If the licensee can deploy the necessary new investment to another opportunity with a greater certainty of return, then it may be unwilling to commit to the licence opportunity without receiving a more generous share of the profits. Some of these considerations are listed in Figure 2 on the following page.

When presenting these factors as evidence in court, it may be persuasive to translate them into the factors relevant for the determination of the reasonable royalty listed in the *AlliedSignal*, *Jay-Lor*, and *Georgia-Pacific* cases discussed below. These factors are only guidelines for ensuring that all relevant business and legal considerations are taken into account.

It is the profit "from the sale of the patented technology" that is important.¹⁰⁶ If the patented technology is one small component of a larger product, such as a patented gas pedal in an automobile, it is not realistic to suppose that the automobile manufacturer would turn over a share of the profit on the entire vehicle for the right to use the patented pedal.

¹⁰³ *Jay-Lor, ibid.*, at 150.

¹⁰⁴ *Jay-Lor, ibid.*, at 157.

¹⁰⁵ *Jay-Lor, ibid.*, at 155.

¹⁰⁶ *Jay-Lor, ibid.*, at 150.

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In cases in which the patented part contributes a substantial part of the value, as was the case in both *AlliedSignal* and *Jay-Lor*, it is appropriate to start with the profit on the entire product as the royalty base and adjust the royalty rate to reflect the value contributed by non-patented parts. It has been suggested that the "smallest priceable component" is a practical choice for the royalty base in such cases.¹⁰⁷ Even then, the rate may need to be adjusted if the patented invention contributes only a part of the value of that component.

AlliedSignal and *Jay-Lor*¹⁰⁸ illustrate the application of the anticipated profits approach. Both cases accepted that a normal split of the profits was in the range of 25 to 33 percent of the profits and then used the same set of factors to adjust the final royalty rate towards the upper or lower end of that range. The proffered relevant factors impact on the royalty rate in that they affect the risk to profit earning. Many of the factors weighed in different directions in the two cases based on the facts.

¹⁰⁷ U.S. Federal Trade Commission, "The Evolving IP Marketplace," *supra* note 10 at 212.

¹⁰⁸ *Jay-Lor*, *supra* note 8.

¹⁰⁹ *Jay-Lor*, *ibid.*, at 160 Rate increased due to technology transfer; *AlliedSignal*, *supra* note 37, p. 179, rate reduced because no technology was transferred.

¹¹⁰ Contrast *Jay-Lor*, *ibid.*, at 161; *AlliedSignal*, *ibid.*

The list of general factors that may be considered in determining the hypothetically negotiated royalty as given by the court in *AlliedSignal* and used in *Jay-Lor* consisted of:

- (i) **Transfer of technology:** The royalty rate will be increased if patentee transferred technology to the defendant, but reduced if the defendant relied on its own technology and needed a licence only to avoid infringement.¹⁰⁹
- (ii) **Difference in the practice of the invention:** The rate will be increased if the processes used by the defendant and patentee are the same, and reduced if the technologies are different. This is related to the transfer of technology factor, above.¹¹⁰
- (iii) **Non-exclusive licence:** The royalty rate is reduced if the hypothetical licence is non-exclusive. This factor is only material where an exclusive licence could potentially be granted. If it is not material, it will not affect the royalty rate.¹¹¹
- (iv) **Territorial limitations:** A more extensive territorial exclusivity will tend to increase the royalty rate.¹¹²
- (v) **Term of the licence:** The longer the licence term relative to the patent term, the higher the royalty; but if non-infringing competition would have reduced the economic value of the patent by the end of its term, a full term licence may be no more valuable than one for a shorter term.¹¹³
- (vi) **Competitive technology:** A technology that is very desirable in comparison with non-infringing alternatives will attract a higher royalty than one that has competing non-infringing alternatives.¹¹⁴
- (vii) **Competition between licensor and licensee:** The fact that the plaintiff and the defendant would be competing against each other would increase the royalty rate. This is an important factor, when applicable.¹¹⁵
- (viii) **Demand for the product:** Increasing demand for the product will increase the royalty rate.¹¹⁶
- (ix) **Risk of product sales:** The rate will be increased if the risk that the product would not sell is low.¹¹⁷
- (x) **Novelty of invention:** If the invention is a significant improvement on the known technology, the royalty rate will tend to increase.¹¹⁸

¹⁰⁹ *Jay-Lor, ibid.*, at 162 (not material); *AlliedSignal, ibid.* (material, non-exclusive licence reduced rate).

¹¹² Compare *Jay-Lor, ibid.*, at 163, finding that "it would have been likely that the parties would have agreed to allow the Defendants the same territory they were selling into," and concluding that this was a neutral factor, with *AlliedSignal, ibid.*, holding that a licence limited to Canada would tend to reduce the rate.

¹¹³ *Jay-Lor, ibid.*, at 164, noting the effect of competition; *AlliedSignal, ibid.*

¹¹⁴ *Jay-Lor, ibid.*, at 165 (no competing technologies); *AlliedSignal, ibid.* (competing technologies available).

¹¹⁵ *Jay-Lor, ibid.*, at 166, noting that competition from the defendants is a factor "very much in favour of the Plaintiffs"; *AlliedSignal, ibid.* (competing technologies).

¹¹⁶ *Jay-Lor, ibid.*, at 167; *AlliedSignal, ibid.*

¹¹⁷ *Jay-Lor, ibid.*, at 168; *AlliedSignal, ibid.*

¹¹⁸ Compare *Jay-Lor, ibid.*, at 169, where the technology was a significant improvement and the rate therefore increased, with *AlliedSignal, ibid.*, where the opposite was true.

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- (xi) **Compensation for research and development costs:** Higher research and development costs will increase the royalty rate; lower research and development costs will reduce it.¹¹⁹
- (xii) **Displacement of business:** If the product is central to the defendant's business, the royalty rate will be higher, while if it is only one business line of many, rates will be reduced.¹²⁰
- (xiii) **Capacity to meet market demand:** The royalty rate will be increased if the patentee has the capacity to meet the market demand itself, and reduced if it does not.¹²¹

The U.S. case of *Georgia-Pacific Corp. v. United States Plywood Corp.*¹²¹ identifies the following possible considerations, many of which duplicate the above list from *AlliedSignal* and used in *Jay-Lor*.

- (i) The royalties received by the patentee for the licensing of the infringed patent, proving (or tending to prove) an established royalty;
- (ii) The rates paid by the licensee for the use of other patents comparable to the patent in suit;
- (iii) The nature and scope of the licence, as exclusive or non-exclusive, or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold;
- (iv) The licensor's established policy and marketing program to maintain its patent monopoly by not licensing others to use the invention or by granting licences under special conditions designed to preserve the monopoly;¹²²
- (v) The commercial relationship between the licensor and licensee, such as whether they are competitors in the same territory in the same line of business or whether they are inventor and promoter;
- (vi) The effect of selling the patented specialty in promoting sales of other products of the licensee, the existing value of the invention to the licensor as a generator of sales of its non-patented items and the extent of such derivative or convoyed sales;
- (vii) The duration of the patent and the term of the licence;
- (viii) The established profitability of the product made under the patent, its commercial success and its current popularity;

¹¹⁹ *Jay-Lor, ibid.*, at 170 (some R&D costs increased the royalty slightly; *AlliedSignal, ibid.* (low R&D costs reduced the rate).

¹²⁰ *Jay-Lor, ibid.*, at 171; *AlliedSignal, ibid.*

¹²¹ Compare *Jay-Lor, ibid.*, at 172; *AlliedSignal, ibid.*

¹²² *Georgia-Pacific, supra* note 92.

¹²³ For example, in *SmithKline Diagnostics Inc. v. Helena Laboratories Corp.* 926 F.2d 1161 at 1168; 17 U.S.P.Q. 2d 1922 at 1928 (Fed. Cir. 1991) the reasonable royalty was raised as the patentee was an "unwilling licensor".

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- (ix) The utility and advantages of the patented property over the old modes or devices, if any, that had been used for working out similar results;
 - (x) The nature of the patented invention, the character of the commercial embodiment of it as owned and produced by the licensor and the benefits to those who have used the invention;
 - (xi) The extent to which the infringer has made use of the invention and any evidence probative of the value of that use;
 - (xii) The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions;
 - (xiii) The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks or significant features or improvements added by the infringer;
 - (xiv) The opinion testimony of qualified experts; and
 - (xv) The amount that a licensor (such as the patentee) and a licensee (such as an infringer) would have agreed upon at the time the infringement began if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee - who desired, as a business proposition, to obtain a licence to manufacture and sell a particular article embodying the patented invention - would have been willing to pay as a royalty and yet be able to make a reasonable profit and which amount would have been acceptable by a prudent patentee who was willing to grant a licence.

Since no prescribed method to determine reasonable royalties would apply in all circumstances, expert witnesses are crucially needed to guide the court through these considerations in the context of the case facts and circumstances.

While the lists above may appear to be somewhat mechanical, both decisions relied on the testimony of expert witnesses to determine whether the factor was relevant, whether other factors ought to have been considered, and the correct weighting of each factor. The list is therefore unique to the two cases - and a starting point for others.

The eventual division of anticipated profits will be further affected by the comparative strengths of the parties and their position in the marketplace as a whole. For example, in *Jay-Lor Snider J.* adjusted the royalty upwards after accepting expert opinion that the defendant would have been willing to pay more because of the potential upside of being both a manufacturer and dealer. If the licensee already possesses established strengths in areas where the licensor is also strong, these strengths tend to offset each other and thus diminish the licensor's bargaining strength. However, if the licensor has numerous strong alternatives for exploitation of the intellectual property, including the possibility of exploiting the technology in-house, the licensor's bargaining position is correspondingly strengthened.

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Regardless of the percentage of the defendant's or plaintiff's anticipated profits to be shared, once determined it is translated into an equivalent percentage of the defendant's sales so as to determine the royalty rate. The process of that translation is beyond the scope of this article but in the simplest case, if defendant's profit is 16 percent of sales, and the royalty is 25 percent of those profits, then the royalty rate will be 25 percent times 16 percent, or 4 percent of sales.

U.S. Law and "The 25% Rule"

As stated above, both *AlliedSignal* and *Jay-Lor* apply the anticipated profits approach by adopting a "normal" split of the profits in the range of 25 percent to 33 percent and then considering various factors to adjust the final royalty rate to reflect the unique facts of the case.

This use of this starting point is sometimes referred to as the 25% Rule and applications of the 25% Rule have been criticized, especially where little or no consideration is given to the unique facts of the case. Some criticisms include:

- (i) the rule ignores precise profits generated by the intellectual property;
- (ii) the rule might ignore a variety of costs, including advertising, distribution,¹²⁴ and the costs of complementary assets;
- (iii) by its very name, a court or other user of the rule might become attached to the 25/75 split, and may not appreciate that it is only a starting point or a paradigm for analysis;¹²⁵ and
- (iv) the rule does not specifically analyze whether the 25 percent rate would provide an adequate return to the rights holder or leave the defendant with appropriate profits.

Recently, in *Uniloc USA, Inc. v. Microsoft Corp.*, the U.S. Federal Circuit Court of Appeals rejected the rule entirely, as "fundamentally flawed," as a tool for determining a baseline royalty rate.¹²⁶ The criticisms made by the court were that:

- (i) it fails to account for the unique relationship between the patent and the accused product;
- (ii) it fails to account for the unique relationship between the parties; and
- (iii) the rule is essentially arbitrary and does not fit within the model of the hypothetical negotiation within which it is based.

The rejection of the 25% Rule in *Uniloc* is not consistent with the adoption of the

¹²⁴ See R.L. Parr, *Intellectual Property Infringement Damages: A Litigation Support Handbook* (Toronto: John Wiley & Sons, 1993), 37 and G.V. Smith and R.L. Parr, *Valuation of Intellectual Property and Intangible Assets*, 2d ed. (Toronto: John Wiley & Sons, 1994). See also criticism of the 25 percent royalty rule in J.W. Schlicher, *Licensing Intellectual Property* (Toronto: John Wiley, 1994), 34.

¹²⁵ See Goldscheider, R., *Technology Management: Law, Tactics, Forms*, (1984) Clark Boardman Callaghan, at §10.04. In particular, deviation from the standard rates may occur most often with drastic or pioneer innovations: these inventions are the most valuable and are perhaps the innovations most in need of legal defence.

¹²⁶ *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1315 (1st Cir. R. 1. 2011), p. 1315 slip op.

anticipated profits approach in *Jay-Lor*.

Goldscheider, a pioneer and continued proponent of the 25% Rule writes:

I believe the Federal Circuit has been misled about the realities of the Classic 25% Rule, which is quite distinguishable from what the Federal Circuit described in *Uniloc* as the "25% Rule of Thumb".¹²⁷

Goldscheider defines the Classic 25% Rule as a flexible method for estimating a baseline royalty based on credible profitability or cost savings to the licensee. Once that baseline royalty is estimated, an expert must still apply other factors, such as the *Georgia-Pacific* factors and non-infringing alternatives to determine the final reasonable royalty. In the hypothetical negotiation with a comprehensive application of the Classic 25% Rule, the baseline royalty estimated at 25 percent is not the end of the analysis.¹²⁸ He considers the "Rule of Thumb" envisaged and disapproved of by the Federal Circuit to simply consist of a fixed ratio of 25/75 for determining baseline royalty requiring no further analysis to arrive at a reasonable royalty.

Goldscheider's comments above appear to be consistent with the objective of the anticipated profits approach in *Jay-Lor*.

While, depending on the fact circumstances, the application of a starting point of 25 percent in the anticipated profits approach may be reasonable when the entire product is patented, it may become increasingly more difficult to apply as the patented component comprises an increasingly smaller proportion of the product.

The impact of *Uniloc*, if any, on Canadian law remains to be determined.

3.3.3.2 The Analytical Approach

The analytical approach estimates a reasonable royalty by subtracting the normal profit margin of the defendant's business from the expected super-profit from the use of the intellectual property.¹²⁹ The absorption cost approach is used to deduct both variable and a portion of fixed costs from the infringer's net sales. The degree of fixed costs to be absorbed is subject to all the usual arguments. The "normal" profit margin is that which would likely have been realized by the infringer if it had sold similar products without infringing the intellectual property. Some or all of the remaining amount ("super-profit") is then awarded to the rights holder as a reasonable royalty.

¹²⁷ Goldscheider, R. *The Classic 25% Rule and the Art of Intellectual Property Licensing* 2011 DUKE L. & TECH. REV.6.

¹²⁸ See Goldscheider, *ibid.*, at footnote 23.

¹²⁹ This approach was originally used upon appeal in *Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers, Inc.* 446 F.2d 295, 170 U.S.P.Q. 369 (2d Cir 1971), and has been used or referred to in a number of cases including *Panduit, Tektronix Inc. v. U.S.* 552 F.2d 343, 193 U.S.P.Q. 385 (Ct. Cl. 1977), *Paper Converting Machine v. Magna-Graphics* 745 F.2d 11, 223 U.S.P.Q. 591 (Fed. Cir. 1984) and *TWG Mfg. Co. v. Dura Corp* 789 F.2d 895 at 899 (Fed. Cir. 1986).

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This approach attempts to split the profits between the plaintiff and the defendant while allowing the defendant to keep a normal level of profits. The practical problem is the determination of what a "normal" profit margin is. The approach must balance the margin that is normal to the defendant and that of the industry in question. It can be difficult to define precisely in what industry or market the infringement is taking place. Even within an industry, there is a wide discrepancy in profit margins, often by almost an order of magnitude. Furthermore, large companies with many product lines may well have large differences in profitability between individual products that relate only in the aggregate to the overall profitability of the company. The logic of this approach suggests that the court will need to apply the infringing defendant's normal profitability of the individual profit line, and not the profitability of the company.

Notwithstanding the foregoing, the plaintiff's normal profit margin is not determinative where an open market bidding process for the licence would produce a higher implied royalty rate. That is to say, the plaintiff should enjoy the higher of the market royalty rate and that which would be paid by the infringing defendant based on the analytical approach.

This analytical approach has three potential pitfalls:

- (i) It ignores the cost or contribution of all other complementary assets unique to the business of the infringer.
- (ii) It leads to erroneous results when the "normal" profits include the use of other intellectual property. For example, suppose a company is found liable for infringing the trade-mark of a well-known soft drink. Finding the "normal" level of profit by looking at the profits of Coca-Cola, Pepsi, and Cadbury-Schweppes would be unfair to the plaintiff, because these companies all have established trade-marks themselves. If the profits of other intellectual property are used to find a normal profit level, the calculation will in effect assume that the infringing company, in the absence of the infringement, would have had legal access to a valuable trade-mark for its products.¹³⁰
- (iii) It ignores the alternative licensees or internal alternatives available in the marketplace. The analytical approach takes as its baseline the profits made by the infringing company. However, if the licensing company had more lucrative options in the marketplace to exploit the intellectual property than hypothetically licensing the defendant, the award should restore the plaintiff to that higher level. The analytical method thus has the added danger of under-compensating the rights holder. Commonwealth case law has a greater focus upon the market than is implied by a narrow "hypothetical negotiation" test. All the opportunities for licensing to other companies should be evaluated in determining the

¹³⁰ Recognizing these limitations, Parr, *supra* note 124 at 159-162, suggests that the "normal profit margin" be replaced by a "commodity product profit margin", where the commodity product margin should be derived from a product that: (1) lacks intellectual property, 2) requires a similar amount of investment in complementary assets, and (3) is in the same (or a closely similar) industry as the infringing product.

reasonable royalty.

The analytical method is different than the investment method (discussed below). It is less comprehensive and, because it focuses on historical costs, does not directly take into account market values. However, when most comprehensively computed, a "normal profit margin" begins to look like economic profit and that, in turn, begins to move towards the result produced by investment return analysis.

3.3.3.3 Investment Return Analysis: The Economic Return from Intellectual Property¹³¹

One approach to the estimation of reasonable royalties (or the negotiation of licences in general) is to determine the royalty rates that will provide an appropriate return on the hypothetical licensee's assets that are contributed to the licensing relationship. Excess return resulting from use of the intellectual property or licence should be available to pay the reasonable royalty.

The primary focus of such an approach is the determination of the maximum royalty rate that will leave the hypothetical licensee with the minimum acceptable investment rate of return on its overall company assets – perhaps the most pertinent factor that drives a reasonable royalty rate.

A commonly accepted standard for a company's minimum return on assets invested is its weighted average cost of capital (WACC). The WACC is the return needed to service the economic capital required by the firm. It is sufficient to service the notional debt and provide a fair rate of return on invested equity.

Note that the licensee's assets in question – the company's assets in the WACC analysis – are all assets including goodwill and other rightly owned intellectual property.

WACC is objectively determinable and is independent of the actual debt and equity of a particular firm. It is a function of the optimal capital structure of the particular firm which in turn is a function of a broad diversity of market and industry factors as well as considerations unique to the firm such as culture, management, and other company-specific risks.

For example, assume that "Infringer" is a division of a large company. Assume that Infringer's sole product line infringes a patent claiming subject-matter essential to the whole product line.

¹³¹ The analysis for this section is largely based on Smith & Parr, *supra* note 124; Parr, *ibid.*; and R.L. Parr, "Advanced Royalty Rates Determination Methods", in R. Parr and P. Sullivan, Eds., *Technology Licensing* (Toronto: John Wiley & Sons, 1996).

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Assume the following about Infringer:

- (i) Enterprise value (comprising debt and equity) of \$40 million;
- (ii) A WACC of 11.25 percent implying it is entitled to a "normal" after tax income of \$4.5 million; and
- (iii) Actual sales of \$1 billion and income of \$7 million after tax or a premium of \$2.5 million after tax, or, say, \$4 million pre-tax, or 0.4 percent of sales.

As may be seen from this analysis, the royalty of 0.4 percent is only a derivative calculation. What is essential is the number of dollars that ought to have been captured by the royalty. If the sales of Infringer had been \$40 million and everything else the same, then the \$4 million of profit in excess of normal profit (often referred to as super-profit) would give rise to a maximum royalty rate 10 percent. This is the maximum as, should the licensee be required to pay over, by way of royalty, the full extent of the excess profit, then there would be no incentive for it to enter into the licence arrangement.

One of the arguments that can be put forward against the above methodology is that the required return on intellectual property embedded in the WACC includes a profit to which Infringer is not entitled. If this is the philosophy of the law, then the royalty would be no less than the 10 percent computed above and the required return may be reduced to a lower level and the royalty consequently increased.

Note how the above analysis has focused solely on the Infringer or notional licensee. Given that the calculation is for damages and not profits to be disgorged, it is also important to look at the circumstances of the rights holder or plaintiff and assess its operating reality.

The estimated \$4 million pre-tax per annum royalty might be reasonable as a starting point. It might be a reasonable ending point if the plaintiff's damages cannot be directly computed.

If the plaintiff has set up all the necessary assets to manufacture and sell the product itself and all such assets were sitting idle as a result of the infringement – that is to say there was no mitigating use for them then the above computed royalty may not be needed as there is a direct means of computing damages – or if it is adopted as the compensatory mechanism then it needs to be reconciled to the return the plaintiff would have otherwise enjoyed but for the infringement. Put another way, the investment return analysis is perhaps an appropriate method only in situations where the plaintiff would not itself have exploited the intellectual property at issue by selling the product itself.

4.0 Other Considerations

4.1 Reasonable Compensation for Pre-Grant Damages

Under s. 55(2) of the Patent Act,¹³² a patentee is eligible for "reasonable compensation" for any damage sustained between the date the application is laid open and the date of the grant of the patent for any activities that would have constituted infringement of the patent had it been in force.

In *Jay-Lor*, Snider J. held that a patentee is not entitled to claim its lost profits as "reasonable compensation". Instead, she equated that term to "reasonable royalty" as understood in the context of post-grant damages. Snider J. did not exclude the possibility that "reasonable compensation" might be interpreted to mean something other than reasonable royalty, but no other alternatives had been argued before her.¹³³ As Snider J. clearly rejected a claim for lost profits under that head, unless future decisions take issue with this interpretation and offer a better alternative, it appears that a patentee's damages will be confined to a reasonable royalty during the laid open period. To put this in context, one needs to refer to the result in *Baker Petrolite Corp. v. Canwell Enviro-Industries Ltd.*,¹³⁴ in which Gibson, J. confined the patentee to nominal compensation of \$1. While these two cases can be formally reconciled, as the express basis for Gibson J.'s holding was that no damages had been proven, it is not clear that the evidentiary bases were in fact significantly different. Thus while *Jay-Lor* does not allow the patentee to recover lost profits during the laid open period, in allowing the patentee to recover a reasonable royalty, it goes beyond the purely nominal award in *Baker Petrolite*.

4.2 Increased Costs in the Context of Reasonable Royalties

As previously noted, unrecovered increased costs as a result of competition from an infringer can be claimed in a claim for lost profits. However, such increased costs are not normally claimed in conjunction with a claim for a reasonable royalty because competition between the licensor and licensee should be explicitly considered under all three methods described above. To award damages for these costs under a separate head would therefore amount to double counting.¹³⁵

4.3 Reasonable Royalties on a Cost Basis

A common method for determining the value of assets is the cost, or replacement cost, approach, which values the asset by assessing how much it would cost to reproduce the future benefits from the asset. For intellectual property, however, this approach is often described as inappropriate for a number of reasons:

¹³² *Patent Act*, R.S.C. 1985, c. P-4.

¹³³ *Jay-Lor*, *supra* note 8, at 122.

¹³⁴ *Baker Petrolite Corp. v. Canwell Enviro-Industries Ltd.*, [2002] 2 F.C. 3, 13 C.P.R. (4th) 193 reserved on other grounds 2002 F.C.A. 158, 17 C.P.R. (4th) 478.

¹³⁵ *Jay-Lor*, *supra* note 8, at 180-81.

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- (i) All of the direct and indirect development costs expended to produce intellectual property are very difficult to define and equally difficult to track.
- (ii) The development costs for a given intellectual property asset may bear no relation to the asset's future economic return.¹³⁶ The true cost of the creative process might genuinely be very low. Equally, it might be better calculated as the accumulated cost of all the company's prior failures.
- (iii) Reproduction cost is only one indicator of value.

As a result, there is a strong argument that the cost of development of the intellectual property should not have a significant impact on the determination of a reasonable royalty. As noted by Goldscheider:

An argument sometimes raised by a proprietor when it is offering an invention for licence is that it has expended enormous time, effort, and money to create and develop the technology involved. A realistic counterargument is that these are sunk costs to the licensor that are irrelevant to the licensee, who is only interested in the future profitability the technology is likely to generate. The elephant may have laboured long and brought forth a mouse — and it is only a mouse that is on the table.¹³⁷

4.4 Non-Confiscatory Royalties

An interesting alternative to the traditional damages and accounting of profits awards arose in *Unilever PLC v. Procter & Gamble*, where Muldoon J. sought to reconcile an avoidance of the difficulties of an accounting of profits with the reluctance of plaintiffs to reveal sensitive information to prove their damages by awarding damages "calculated upon a generous, but non-confiscatory, rate of royalty."¹³⁸ His reasoning is best explained in an unrelated ruling on a motion in the *Scientific Games* case:

[Accounting of profits is a difficult remedy, and should be avoided where possible. However, some commentators object to this because] when patentees are limited to a remedy in damages, they may thereby be obligated to disclose to the infringer, possibly a competitor in trade, information which could prove compromising to the patentee's business. But such would not be the case at all if damages were equated to royalties which could be, in the Court's discretion, non-confiscatory or indifferent as to whether confiscatory or not. Then no disclosure would be needed from the successful plaintiff. It would be up to the defendant to prove at what level royalties would be confiscatory or not.¹³⁹

¹³⁶ For example, in the 1950s, the U.S. government spent approximately \$100 million researching nuclear-powered aircraft, which were never able to develop enough thrust for takeoff. The future economic value of aircraft engine technology that fails to fly is presumably zero. See Parr, *supra* note 124, at 173.

¹³⁷ See Goldscheider, *supra* note 125, at \$10.03.

¹³⁸ *Unilever PLC v. Procter & Gamble Inc.* (1993), 47 C.P.R. (3d) 479, at 572 (F.C.T.D.). The award was set at an amount greater than a reasonable royalty as compensation for the non-issuance of an injunction against the defendant.

¹³⁹ *Scientific Games Inc. v. Pollard Banknotes Ltd.* (1997), 76 C.P.R. (3d) 22, at 33-34 (F.C.T.D.).

The award in the *Unilever* case was upheld by the Federal Court of Appeal, which explicitly recognized that the award could be higher than the maximum royalty the defendants would have accepted in a hypothetical negotiation:

Here, the respondents asked the trial judge to award the equitable remedy of accounting for the profits earned by the appellants by reason of their infringement....For their part, the appellants asked that the award be limited to what they would have had to pay if, instead of infringing the patent, they had become licensees of the patentee. For the reasons which he gave, the trial judge chose a middle ground. That choice is not prohibited by authority or language of s. 55(1) of the [Patent Act] and, in my view, is consistent with that language.¹⁴⁰

It should be noted that the "generous, but non-confiscatory rate of royalties" in *Unilever PLC v. Procter & Gamble* is likely not equivalent to a reasonable royalty. Typically, a reasonable royalty is struck as the midpoint within a reasonable range of royalties. A "generous, but non-confiscatory rate of royalties" might be at the high end of the range, although not so high as to be an unreasonable award.

It is unclear whether the generous, non-confiscatory royalty award is limited to cases where a reasonable royalty normally applies.¹⁴¹ If not, this remedy's floor of reasonable royalties potentially over-compensates the plaintiff, while its ceiling of the defendant's profits potentially under-compensates it.

Finally, from a theoretical point of view, this award also begins to lose contact with the principle of restoration. The award appears to simply find a monetary amount within the range of possible awards, while possibly approximating neither an accounting of profits award nor a restorative award.

4.5 Damages Under Section 8 of PM(NOC) Regulations

Under the Patented Medicine (Notice of Compliance) Regulations ("the Regulations"), a generic pharmaceutical company seeking a Notice of Compliance ("NOC") on the basis of an Abbreviated New Drug Submission which compares its drug to a previously approved drug, must address all the patents listed on the Patent Register in respect of that previously approved drug before its NOC will be issued. If the generic wishes to launch prior to expiry of the listed patents, it must allege its product will not infringe the listed patents, or that those patents are invalid. The patentee may respond to this allegation by seeking an order of prohibition preventing the Minister of Health from issuing the NOC. An application for an order of prohibition

¹⁴⁰*Procter & Gamble v. Unilever PLC* (1995), 61 C.P.R. (3d) 499, at 523-524 (F.C.A.). In contrast to the American and Federal Court of Appeal decisions, Falconer J. in the reference in *Catnic*, *supra* note 6, at 532-533, appeared reluctant to follow through on this reasoning, and instead focused on what the licensee would have agreed to pay.

¹⁴¹In *Unilever*, *supra* note 138, the plaintiff did not market the substance of its invention in Canada, and so would not have been eligible for a lost profits award in any case.

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triggers an automatic 24-month stay preventing the grant of the NOC until the listed patents have been addressed. Under section 8 of the Regulations, a generic whose NOC has been delayed by an application for an order of prohibition may bring an action for damages against the patentee that brought the application if the application is dismissed by the court or discontinued by the party bringing the application.¹⁴² The patentee is liable for "any loss suffered during the period (a) beginning on the date, as certified by the Minister, on which a notice of compliance would have been issued in the absence of these Regulations, unless the court concludes that ... a date other than the certified date is more appropriate; and (b) ending on the date of the withdrawal, the discontinuance, the dismissal or the reversal".

The Federal Court of Appeal has held, with one caveat, that the standard "but for" approach to causation is applicable in assessing damages under section 8: "The Federal Court [has] to assess [the generic's] damages on the basis of a hypothetical question: what would have happened had [the patentee] not brought an application for prohibition?"¹⁴³ In the first decisions to assess section 8 damages, Snider J. strictly applied this "but for" approach, stating "I must construct a hypothetical, or 'but for', world during a defined period of time in the past in order to determine what share of the [drug's] market [the generic] would have captured had it been able to sell its generic [version of the drug]."¹⁴⁴ Applying this "but for" approach requires a detailed factual inquiry into both the capacity of the generic to produce the drug, and the market share it would have captured. Snider J. held that in constructing the "but for" world, the possibility of multiple generic entrants and the possibility of entry by an authorized generic, must both be considered.¹⁴⁵ In considering the sales that would have been captured by the generic, Snider J. relied extensively on detailed econometric evidence, as well as expert accountants who prepared the final damages calculation.¹⁴⁶

There is one caveat to the general rule that damages under section 8 are to be assessed on the basis of "but for" causation. The Federal Court of Appeal has held that that the damages pursuant to section 8 are not to include an amount in respect of losses beyond the delay period, such as lost sales during the period in which actual sales are "ramping up" to steady state levels and possible lost sales from a

¹⁴² Under the Regulations, a drug manufacturer may list patents it holds that cover a drug product (for which it has already received a Notice of Compliance or NOC) on the Patent Register. If a second company (often a generic drug company) submits an abbreviated new drug submission seeking an NOC for the same drug product, it must either agree to wait for the expiry of the related patents on the Register or allege that the patent will not be infringed by their drug product, is invalid, or improperly listed. If the drug manufacturer wishes to contest the allegation(s), it may apply to the Federal Court under the Regulations for an order prohibiting the Minister of Health from issuing an NOC until the patent has expired. The allegations are considered by the court in an expedited fashion, but in the meantime the Minister is prohibited from issuing the NOC to the second company for 24 months or until the court decides the application. This is similar to granting the drug manufacturer an automatic interlocutory injunction.

¹⁴³ *Merck Frost Canada & Co. v. Apotex Inc.* 2011 FCA 329 at 75.

¹⁴⁴ *Sanofi-Aventis Canada Inc. v. Teva Canada Ltd.*, 2012 FC 552 at 5; and see similarly *Apotex Inc. v. Sanofi-Aventis*, 2012 FC 553 at 6.

¹⁴⁵ *Sanofi-Aventis v. Teva*, *ibid.*, at 123, 184.

¹⁴⁶ See e.g. *Sanofi-Aventis v. Teva*, *ibid.*, at 77-106, 209-220 (econometric evidence), 221 referring to "expert accountants", and generally Part IX damages calculations using that evidence.

permanent loss of market share caused by delayed entry, as such losses are not suffered during the delay period.¹⁴⁷ That is, losses incurred outside the delay period are not compensable, even if they were caused by the delay.¹⁴⁸ This reflects the Court of Appeal's understanding of Parliament's intentions in enacting section 8 of the Regulations. Consequently, in assessing section 8 damages, Snider J. held that "lost business value" and "duplicate ramp-up" were not compensable losses.¹⁴⁹

4.6 Interest

4.6.1 Prejudgment Interest

Interest was traditionally not awarded on damages at law, as it was thought to be punitive.¹⁵⁰ *A fortiori*, compound interest was not permitted. This has been statutorily remedied in each province to the extent of permitting interest to be awarded, both pre- and post-judgment.¹⁵¹ While the Acts generally give broad discretion to the courts in awarding interest, many of the Acts, including both the *Federal Courts Act*, and the *Ontario Courts of Justice Act* which are substantially similar, prohibit compound interest pre-judgment.¹⁵² The Federal Court generally does not award compound interest, and in the absence of evidence on the point, the Federal Court typically awards pre-judgment interest at the annual average Bank of Canada bank rate (the rate of interest the Bank of Canada charges on one-day loans to major financial institutions), not compounded.¹⁵³ As the bank rate is in general unrealistically low for long-term investment or borrowing, and because only simple interest is awarded, such an award will not provide full compensation to the successful party. Note that this practice is in contrast to an accounting of profits, where the general rule is to award compound interest at a rate somewhat greater than the bank rate.¹⁵⁴

¹⁴⁷ *Apotex Inc. v. Merck & Co.*, 2009 FCA 187, [2010] 2 F.C.R. 389 (under the Regulations as they stood prior to October 2006); *Teva Canada Ltd v. Sanofi-Aventis Canada Inc. / ramipril (NOC)* 2011 FCA 149 Dawson J.A. for himself and Noël J.A., Sharlow J.A. dissenting.

¹⁴⁸ *Sanofi-Aventis v. Teva*, *supra*, note 144 at 270, where Snider J. states "The claimed loss—however named—falls squarely within the exceptions set out in *Alendolate* (FCA) and, unfortunately, is not recoverable."

¹⁴⁹ *Sanofi-Aventis v. Teva*, *ibid.*, at 254.

¹⁵⁰ *London, Chatham & Dover Ry. Co. v. South Eastern Ry. Co.* [1893] A.C. 429 (H.L.).

¹⁵¹ See generally M.A. Waldron, *The Law of Interest in Canada* (Scarborough: Carswell, 1992).

¹⁵² See *Federal Courts Act*, R.S.C. 1985, c.F-7, s. 36-37 and s. 36(4)(b) "Interest shall not be awarded under subsection (1), (b) on interest accruing under this section"; *Courts of Justice Act*, R.S.O. 1990, c. C.43, s. 128-129 and ss 128(4)(b). The *Federal Courts Act* provides that if a cause of action arises solely in one province (i.e. infringement occurs entirely and only in one province), the laws of that province govern the award of interest, and otherwise the provisions of the *Federal Courts Act* are applicable: *Federal Courts Act*, R.S.C. 1985, c.F-7, s. 36-37.

¹⁵³ See *Merck & Co., Inc. v. Apotex Inc.* 2006 FC 524 [240] *affm'd* 2006 FCA 323; *Laboratoires Servier v. Apotex Inc.* 2008 FC 825, 67 C.P.R. (4th) 241 *affm'd* 2009 FCA 222, 75 C.P.R. (4th) 443; see also *AlliedSignal*, *supra* note 37, at 190-91, awarding simple interest at rates established in the Ontario Gazette.

¹⁵⁴ See "Accounting of Profits in Intellectual Property Cases in Canada" *supra*, note 15; and see *AlliedSignal*, *ibid.* at 190 expressly contrasting damages and an accounting of profits.

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In *Bank of America Canada v. Mutual Trust Co.*¹⁵⁵ the Supreme Court recognized that interest is not punitive, but compensatory, and held that "the common law now incorporates the economic reality of compound interest. The restrictions of the past should not be used today to separate the legal system from the world at large."¹⁵⁶ Further, the Court also recognized that compound interest is required to provide full compensation, and that "[a]lthough not historically available, compound interest is well suited to compensate a plaintiff for the interval between when damages initially arise and when they are finally paid."¹⁵⁷ The Court held that the prohibition on compound interest under the *Ontario Courts of Justice Act* was not applicable because the interest was being awarded on the basis of common law, not the statute.¹⁵⁸ The *Federal Courts Act* is the same as the *Ontario Courts of Justice Act* in the relevant provisions, so it seems clear that this conclusion applies under the *Federal Courts Act* as well.

However, the Court's decision in the *Bank of America Canada* case was limited in that the Court held that "[a]n award of compound pre- and post-judgment interest will generally be limited to breach of contract cases where there is evidence that the parties agreed, knew, or should have known, that the money which is the subject of the dispute would bear compound interest as damages."¹⁵⁹ On the facts, the contract in question was a contract to lend money, and compound interest was specified in the agreement itself. In other cases [compound interest] "may be awarded as consequential damages in other cases but there would be the usual requirement of proving that damage component."¹⁶⁰ Thus while compound interest will normally be awarded in financial contract cases, in intellectual property cases the loss and the appropriate rate of interest will have to be proven. The most significant case on point is the decision of Gauthier J. in *Eli Lilly Co. v. Apotex Inc.*¹⁶¹ In that case Gauthier J. reviewed the jurisprudence, including the Supreme Court decision in *Bank of America Canada* case, and concluded that the successful patentee would be entitled to compound interest if it could be proven that this was necessary to achieve full compensation.¹⁶² Because that proof was not available to her, she awarded only simple interest at the bank rate, but left it open to the patentee to establish a higher rate, including compound interest, on the reference.¹⁶³ Gauthier J.'s holding on this point appears to be clearly consistent with the *Bank of America Canada* decision. It remains to be seen what kind of proof will be required to establish an entitlement to compound interest. It seems that in the absence of at least some proof, compound interest may be denied.¹⁶⁴

¹⁵⁵ *Bank of America Canada v. Mutual Trust Co.*, 2002 SCC 43, [2002] 2 S.C.R. 601.

¹⁵⁶ *Ibid.*, at 44.

¹⁵⁷ *Ibid.*, at 38.

¹⁵⁸ *Ibid.*, at 43.

¹⁵⁹ *Ibid.*, at 55.

¹⁶⁰ *Ibid.*

¹⁶¹ *Eli Lilly Co. v. Apotex Inc.*, 2009 FC 991, 80 C.P.R. (4th) 1, aff'd 2010 FCA 240.

¹⁶² *Ibid.*, at 674.

¹⁶³ *Ibid.*

¹⁶⁴ *Elders Grain Co. v. The "M/V Ralph Misener"* 2004 FC 1285, para. 10.

4.6.2 Post-judgment Interest

The Acts providing for the award of interest typically distinguish between pre- and post-judgment interest.¹⁶⁵ The *Federal Courts Act*, in particular, gives discretion to the court to set post-judgment interest "at the rate that court considers reasonable in the circumstances," and there is no specific prohibition on compound interest.¹⁶⁶ Further, in *Bank of America Canada*, the Supreme Court expressly held "[t]his analysis applies equally to pre-judgment interest and post-judgment interest."

Nonetheless, in *Eli Lilly v. Apotex* in 2009 Gauthier J. held that "it is well established that the appropriate rate is 5 percent, not compounded." While it is true that this has been the normal award, none of the authorities Gauthier J. cited considered the *Bank of America Canada* decision.

Eli Lilly may be contrasted with *Astrazeneca Canada Inc. v. Apotex Inc.*, a 2011 decision in which Hughes J. awarded compound post-judgment interest at a commercially reasonable rate.¹⁶⁷ While Hughes J. did not cite *Bank of America Canada*, his award is fully consistent with it. As there is substantial discretion in the award of post-judgment interest, it remains to be seen whether the award of Hughes J. marks a shift in practice.

Hughes J. also ruled that interest should not accrue from the date of judgment to the date costs were fixed, and also gave the applicant three weeks to pay costs from the date costs were fixed without any interest accruing.

4.6.3 Interest and Tax

Finally, where large sums are involved over an extended period of time, the benefit to the plaintiff of receiving pre-judgment interest on pre-tax damages can be substantial. The plaintiff would not normally have had the benefit of interest on pre-tax profits and, hence, care needs to be taken to derive the appropriate pre-judgment interest amount having regard to this anomaly. It is possibly most appropriate, in light of the above anomaly, that if interest is to be awarded, it should be pre-tax interest compounded on after-tax amounts—that is, the interest awarded should be such that, after taxes are deducted on the damages award, the interest component would be equivalent to compound interest on the after-tax component of damages, adjusted also for tax on that interest.

¹⁶⁵ *Federal Courts Act*, R.S.C. 1985, c.F-7, s. 37(2).

¹⁶⁶ *Eli Lilly v. Apotex*, *supra* note 161, at 675.

¹⁶⁷ *Astrazeneca Canada Inc. v. Apotex Inc.*, 2011 FC 663, at 5.

4.7 Currency Exchange

The federal *Currency Act* requires that all judgments be given in Canadian dollar amounts. Thus even when damages are incurred and proven in a foreign currency, the award must be in Canadian dollars. The Supreme Court has held that in general currency must be converted as of the date of the commission of the tort.¹⁶⁸ This so-called "breach date" rule may be under- or over-compensatory if exchange rates have changed from the time of the breach to the time of judgment. However, in *AlliedSignal*, Heald J. held that the breach date rule was not applicable, because there was no single breach date for an ongoing infringement. He therefore converted the award at the date of judgment. Given the specific facts of the case, the later award is more fair. In a world where currency exchange rates are volatile, each case will demand a tailored solution.

4.8 Punitive Damages

Punitive or exemplary damages are not compensatory. The purpose of such an award is to punish a defendant for "malicious, oppressive and high-handed" misconduct that "offends the court's sense of decency" and represents a "marked departure from ordinary standards of decent behaviour."¹⁶⁹ The Supreme Court set out the circumstances whereby punitive damages may be awarded in *Honda Canada Inc. v. Keayes*, in which Bastarache J. said "punitive damages are restricted to advertent wrongful acts that are so malicious and outrageous that they are deserving of punishment on their own."¹⁷⁰ Punitive damages are in principle available in Canada in intellectual property cases, including patent and copyright infringement.¹⁷¹

Punitive damages will only be awarded when compensatory damages and other normal civil remedies are insufficient to accomplish the objectives of deterrence and denunciation of wrongful conduct.¹⁷² Historically, punitive damages have very rarely been awarded in patent cases. The mere fact of knowing or intentional infringement has been held to be insufficient to justify an award of punitive damages.¹⁷³ The reluctance to award punitive damages may also be because there is frequently some legitimate uncertainty as to the validity of a patent and/or the scope of its claims until it is tested in court, so that even willful infringement of a granted patent has seldom been considered in Canada to be oppressive or malicious.¹⁷⁴ The decision of Cullen J. in *Lubrizol*¹⁷⁵ awarding \$15 million in punitive damages is the exception that proves the

¹⁶⁸ Established by the Supreme Court of Canada in *Custodian v. Blucher*, [1927] 3 D.L.R. 40 (S.C.C.) and *Gatineau Power v. Crown Life Insurance*, [1945] S.C.R. 655.

¹⁶⁹ *Whiten v. Pilot Insurance*, [2002] 1 S.C.R. 595, 2002 SCC 18, at 36.

¹⁷⁰ *Honda Canada Inc. v. Keayes*, [2008] 2 S.C.R. 362, at 62.

¹⁷¹ *Lubrizol Corp. v. Imperial Oil Ltd.*, [1996] 3 F.C. 40, 67 C.P.R. (3d) 1 (Fed. C.A.) at 33.

¹⁷² *Apotex Inc. v. Merck & Co.*, 2003 FCA 291 at 34.

¹⁷³ *Dimplex North America Ltd. v. CFN Corp.*, 2006 FC 586, 54 C.P.R. (4th) 435, at 123.

¹⁷⁴ Punitive damages were awarded at trial in *Polansky Electronics Ltd. v. AGT Ltd.*, (1993), 3 C.P.R. (4th) 34 (Alta. Q.B.), at 62-64, rev'd. on other grounds (2001), 11 C.P.R. (4th) 7 (Alta. C.A.). However, it should be noted that the Alberta Queen's Bench is an unusual venue for patent litigation, and this should not be considered as reflective of Federal Court practice.

¹⁷⁵ *Lubrizol Corp. v. Imperial Oil Ltd.* (1994) 58 C.P.R. (3d) 167.

rule. In that case, an important aggravating factor was that an interlocutory injunction had been granted prohibiting the defendant from selling the product in question pending trial and the infringement giving rise to the punitive damages was a "deliberate, flagrant and callous disregard" of that injunction.¹⁷⁶ The defendant should have been aware its conduct was wrongful, not just because it was infringing a patent, which it might reasonably have believed to be invalid, but because in so doing it was disobeying an order of the court, which was applicable regardless of whether the patent was ultimately determined to be valid. The Court of Appeal affirmed the availability of punitive damages in those circumstances, while emphasizing the breach of the injunction as an aggravating factor.¹⁷⁷

A further example is the decision by the Federal Court in *Eurocopter v. Bell Helicopter*¹⁷⁸ which recognized that an award of ordinary damages would be insufficient to achieve the goal of punishment and deterrence. In this case the Court ordered punitive damages after Martineau J. concluded that there was "clear evidence of bad faith and egregious conduct" on the part of Bell, stating that "Bell has shown no remorse and offered no excuse for its behaviour" and that Bell's assertion that it had no knowledge of Eurocopter's patent was "simply not plausible and contrary to the evidence." However, Eurocopter's damages would be low, as Bell did not make any sales of helicopters incorporating the infringed patent. The Court concluded that punitive damages were required not only to punish Bell but also to deter others from acting in a similar manner.

Punitive damages are relatively more common in copyright and trademark cases, particularly in cases in which the defendant's business model is centered knowingly selling pirated products. In such cases significant punitive awards, from \$50,000 to \$300,000 have been awarded.¹⁷⁹

¹⁷⁶ *Lubrizol, ibid.*, at 4.

¹⁷⁷ *Lubrizol Corp. v. Imperial Oil Ltd.* (1996) 67 C.P.R. (3d) 1 (F.C.A.), at 38. The Court of Appeal allowed the appeal against the order on the basis that punitive damages could not be assessed until after general damages had been assessed, as it is necessary to know the general damages in order to determine whether additional punitive damages are necessary as a deterrent: see *ibid.*, at 36.

¹⁷⁸ *Eurocopter v. Bell Helicopter Textron Canada Limitée*, 2012 FC 113, at 417-456. At the time of publishing this article, the decision is under appeal by Bell to the Federal Court of Appeal, so *Eurocopter* may not be the last word in punitive damages in patent infringement cases.

¹⁷⁹ See *Microsoft Corporation v. 1276916 Ontario Ltd.*, 2009 FC 849, at 45-49 for a review of the cases.

4.9 Nominal Damages

In cases involving pirated trade-marked or copyrighted goods, it may be difficult to establish the plaintiff's lost profits, because it may not be plausible that a person who knowingly bought a "knock-off" would otherwise have bought the genuine article.¹⁸⁰ At the same time, it may be difficult to establish defendant's profits, as such defendants often do not keep records, and may not appear to defend the action. In such cases the courts have awarded so-called "nominal" damages. These are not "nominal" in the sense of being a trivial sum that serves only to signal that the plaintiff's right has been infringed. Rather, they are substantial damages set on a fixed scale that is not directly related to the loss suffered by the plaintiff. In a 1997 decision the Federal Court applied the following scale: \$3,000 where the defendants were operating from temporary premises such as flea markets; \$6,000 where the defendants were operating from conventional retail premises; and \$24,000 where the defendants were manufacturers and distributors of counterfeit goods.¹⁸¹ Those amounts are subject to adjustment for inflation.¹⁸²

5.0 Conclusion

The determination of damages or profits in a patent case, or indeed any intellectual property case, can be complicated, particularly if the matter is hotly contested between two parties willing to commit considerable resources to litigation: The assessment involves the argument of hypotheticals, and arguments can involve complex market and economic analysis.

In assisting the courts in this task, participants might be guided by the eternal advice to "keep it simple", but should also be mindful of essential business economics underlying damages calculations.

¹⁸⁰ *Louis Vuitton Malletier S.A. v. Yang* 2007 FC 1179, at 31.

¹⁸¹ *Nike Canada Ltd. v. Goldstar Design Ltd. et al.*, T-1951-95, unreported, (F.C.T.D.), cited in *Louis Vuitton Malletier S.A. v. 486353 B.C. Ltd.*, 2008 BCSC 799, at 57, 61-62. Nominal damages are normally awarded in relation to the execution of an Anton Piller order, on a per infringement basis.

¹⁸² *Louis Vuitton*, *supra* note 180, at 43.

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Association canadienne des libertés civiles

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À titre personnel

- Thomas Keenan, professeur, University of Calgary
- Ken Rubin, chercheur d'enquête, protecteur des consommateurs
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